means ''paid or accrued by or on behalf of.''

(2) The term *foreign country* means any foreign state, any possession of the United States, and any political subdivision of any foreign state or of any possession of the United States. The term ''possession of the United States'' includes Puerto Rico, the Virgin Islands, Guam, the Northern Mariana Islands and American Samoa.

(3) The term *foreign levy* means a levy imposed by a foreign country.

(h) *Effective date*—(1) *In general.* This section, § 1.901–2A, and § 1.903–1 apply to taxable years beginning after November 14, 1983. In addition, a person may elect to apply the provisions of this section, § 1.901–2A, and § 1.903–1 to earlier years. See paragraph (h)(2) of this section.

(2) *Election to apply regulations to earlier years*—(i) *Scope of election.* An election to apply the provisions of this section, § 1.901–2A, and § 1.903–1 to taxable years beginning on or before November 14, 1983, is made with respect to one or more foreign states and possessions of the United States with respect to a taxable year of the person making the election beginning on or before November 14, 1983. Such election requires all of the provisions of this section, § 1.901–2A, and § 1.903–1 to be applied to such taxable year and to all subsequent taxable years of the person making the election (''elected years''). If an election applies to a foreign state or to a possession of the United States (''election country''), it applies to all taxes of the election country and to all taxes of all political subdivisions of the election country. An election does not apply to foreign taxes carried forward to any elected year from any taxable year to which the election does not apply. Such election does apply to foreign taxes carried back or forward from any elected year to any taxable year.

(ii) *Effect of election.* An election to apply the regulations to earlier years has no effect on the limitations on assessment and collection or on the limitations on credit or refund (see chapter 66 of the Internal Revenue Code).

(iii) *Manner of making election.* An election to apply the regulations to one or more earlier taxable years is made by attaching a statement to a return, amended return, or claim for refund for the earliest taxable year to which the election relates. Such statement shall state that the election is made and, unless the election is to apply to all foreign countries, the statement shall designate the election countries. In the absence of such a designation of the election countries, all foreign countries shall be election countries.

(iv) *Time for making election.* An election to apply the regulations to earlier taxable years must be made by October 12, 1984, except that if a person who has deducted (instead of credited) foreign taxes in its United States income tax return for such an earlier taxable year validly makes an election to credit (instead of deduct) such taxes in a timely filed amended return for such earlier taxable year and such amended return is filed after such date, an election to apply the regulations to such earlier taxable year must be made in such amended return.

(v) *Revocation of election.* An election to apply the regulations to earlier taxable years may not be revoked.

(vi) *Affiliated groups.* A member of an affiliated group that files a consolidated United States income tax return may apply the regulations to earlier years only if an election to so apply them has been made by the common parent of such affiliated group on behalf of all members of the group.

(Approved by the Office of Management and Budget under control number 1545–0746)

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§ 1.901–2A Dual capacity taxpayers.

(a) *Application of separate levy rules as applied to dual capacity taxpayers*—(1) *In general.* If the application of a foreign levy (as defined in § 1.901–2(g)(3)) is different, either by the terms of the levy or in practice, for dual capacity taxpayers (as defined in § 1.901–2(a)(2)(ii)(A)) from its application to other persons, then, unless the only such difference is that a lower rate (but the same base) applies to dual capacity taxpayers, such difference is considered to be related to the fact that dual capacity taxpayers receive, directly or indirectly, a specific economic benefit (as defined in § 1.901–2(a)(2)(ii)(B)) from the foreign country and thus to be a difference in kind, and not merely of degree. In such a case, notwithstanding any contrary provision of §1.901–2(d), the levy as applicable to such dual capacity taxpayers is a separate levy (within the meaning of §1.901–2(d)) from the levy as applicable to such other persons, regardless of whether such difference is in the base of the levy, in the rate of the levy, or both. In such a case, each of the levy as applied to dual capacity taxpayers and the levy as applied to other persons must be analyzed separately to determine whether it is an income tax within the meaning of §1.901–2(a)(1) and whether it is a tax in lieu of an income tax within the meaning of §1.903–1(a). However, if the application of the levy is neither different by its terms nor different in practice for dual capacity taxpayers from its application to other persons, or if the only difference is that a lower rate (but the same base) applies to dual capacity taxpayers, then, in accordance with §1.901–2(d), such foreign levy as applicable to dual capacity taxpayers and such levy as applicable to other persons together constitute a single levy. In such a case, no amount paid (as defined in §1.901–2(g)(1)) pursuant to such levy by any such dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit, and such levy, as applicable in the aggregate to such dual capacity taxpayers and to such other persons, is analyzed to determine whether it is an income tax within the meaning of §1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of §1.903–1(a). Application of a foreign levy to dual capacity taxpayers will be considered to be different in practice from application of that levy to other persons, even if no such difference is apparent from the terms of the levy, unless it is established that application of that levy to dual capacity taxpayers does not differ in practice from its application to other persons.

(2) *Examples*. The provisions of paragraph (a)(1) of this section may be illustrated by the following examples:

Example 1. Under a levy of country X called the country X income tax, every corporation that does business in country X is required to pay to country X 40 percent of its income from its business in country X. Income for purposes of the country X income tax is computed by subtracting specified deductions from the corporation's gross income derived from its business in country X. The specified deductions include the corporation's expenses attributable to such gross income and allowances for recovery of the cost of capital expenditures attributable to such gross income, except that under the terms of the country X income tax a corporation engaged in the exploitation of minerals K, L or M in country X is not permitted to recover, currently or in the future, expenditures it incurs in exploring for those minerals. In practice, the only corporations that engage in exploitation of the specified minerals in country X are dual capacity taxpayers. Thus, the application of the country X income tax to dual capacity taxpayers is different from its application to other corporations. The country X income tax as applied to corporations that engage in the exploitation of minerals K, L or M (dual capacity taxpayers) is, therefore, a separate levy from the country X income tax as applied to other corporations. Accordingly, each of (i) the country X income tax as applied to such dual capacity taxpayers and (ii) the country X income tax as applied to such other persons, must be analyzed separately to determine whether it is an income tax within the meaning of §1.901–2(a)(1) and whether it is a tax in lieu of an income tax within the meaning of §1.903–1(a).

Example 2. The facts are the same as in example 1, except that it is demonstrated that corporations that engage in exploitation of the specified minerals in country X and that are subject to the levy include both dual capacity taxpayers and other persons. The country X income tax as applied to all corporations is, therefore, a single levy. Accordingly, no amount paid pursuant to the country X income tax by a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit; and, if the country X income tax is an income tax within the meaning of §1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of §1.903–1(a), it will be so considered in its entirety for all corporations subject to it.

Example 3. Under a levy of country Y called the country Y income tax, each corporation incorporated in country Y is required to pay to country Y a percentage of its worldwide income. The applicable percentage is greater for such corporations that earn more than a specified amount of income than for such corporations that earn less than that amount. Income for purposes of the levy is computed by deducting from gross income specified types of expenses and specified allowances for capital expenditures. The expenses for which deductions are permitted differ depending on the type of business in which the corporation subject to the levy is engaged, *e.g.*, a deduction for interest paid to a related party is not allowed for corporations engaged in enumerated types of activities. In addition, carryover of losses from one taxable period to another is permitted for corporations engaged in specified types of activities, but not for corporations engaged in other activities. By its terms, the foreign levy makes no distinction between dual capacity taxpayers and other persons. It is established that in practice the higher rate of the country Y income tax applies to both dual capacity taxpayers and other persons and that in practice the differences in the base of the country Y income tax (*e.g.*, the lack of a deduction for interest paid to related parties for some corporations subject to the levy and the lack of a carryover provision for some corporations subject to the levy) apply to both dual capacity taxpayers and other persons. The country Y income tax as applied to all corporations incorporated in country Y is therefore a single levy. Accordingly, no amount paid pursuant to the country Y income tax by a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit; and if the country Y income tax is an income tax within the meaning of §1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of §1.903–1(a), it will be so considered in its entirety for all persons subject to it.

Example 4. The facts are the same as in example 3, except that it is not established that in practice the higher rate does not apply only to dual capacity taxpayers. By reason of such higher rate, application of the country Y income tax to dual capacity taxpayers is different in practice from application of the country Y income tax to other persons subject to it. The country Y income tax as applied to dual capacity taxpayers is therefore a separate levy from the country Y income tax as applied to other corporations incorporated in country Y. Accordingly, each of (i) the country Y income tax as applied to dual capacity taxpayers and (ii) the country Y income tax as applied to other corporations incorporated in country Y, must be analyzed separately to determine whether it is an income tax within the meaning of §1.901–2(a)(1) and whether it is a tax in lieu of an income tax within the meaning of §1.903–1(a).

Example 5. Under a levy of country X called the country X tax, all persons who do not engage in business in country X and who receive interest income from residents of country X are required to pay to country X 25 percent of the gross amount of such interest income. It is established that the country X tax applies by its terms and in practice to certain banks that are dual capacity taxpayers and to persons who are not dual capacity taxpayers and that application to such dual capacity taxpayers does not differ by its terms or in practice from application to such other persons. The country X tax as applied to all such persons (both the dual capacity taxpayers and the other persons) is, therefore, a single levy. Accordingly, no amount paid pursuant to the country X tax by such a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit; and, if the country X tax is a tax in lieu of an income tax within the meaning of §1.903–1(a), it will be so considered in its entirety for all persons subject to it.

Example 6. Under a levy of country X called the country X tax, every corporation incorporated outside of country X (''foreign corporation'') that maintains a branch in country X is required annually to pay to country X 52 percent of its net income attributable to that branch. It is established that the application of the country X tax is neither different by its terms nor different in practice for certain banks that are dual capacity taxpayers from its application to persons (which may, but do not necessarily, include other banks) that are not dual capacity taxpayers. The country X tax as applied to all foreign corporations with branches in country X (*i.e.*, both those banks that are dual capacity taxpayers and the foreign corporations that are not dual capacity taxpayers) is, therefore, a single levy. Accordingly, no amount paid pursuant to the country X tax by a bank that is a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit; and, if the country X tax is an income tax within the meaning of §1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of §1.903–1(a), it will be so considered in its entirety for all persons subject to it.

Example 7. Under a levy of country H called the country H tax, all corporations that are organized outside country H and that do not engage in business in country H are required to pay to country H a percentage of the gross amount of interest income derived from residents of country H. The percentage is 30 percent, except that it is 15 percent for a specified category of corporations. All corporations in that category are dual capacity taxpayers. It is established that the country H tax applies by its terms and in practice to dual capacity taxpayers and to persons that are not dual capacity taxpayers and that the only difference in application between such dual capacity taxpayers and such other persons is that a lower rate (but the same base) applies to such dual capacity taxpayers. The country H tax as applied to all such persons (both the dual capacity taxpayers and the other persons) is, therefore, a single levy. Accordingly, no amount paid pursuant to the country H tax by such a dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit, and if the country H tax is a tax in lieu of an income tax within the meaning of §1.903–1(a), it will be so considered in its entirety for all persons subject to it.

(b) *Burden of proof for dual capacity taxpayers*—(1) *In general.* For credit to be allowable under section 901 or 903, the person claiming credit must establish that the foreign levy with respect to which credit is claimed is an income tax within the meaning of §1.901–2(a)(1) or a tax in lieu of an income tax within the meaning of §1.903–1(a), respectively. Thus, such person must establish, among other things, that such levy is a tax. See §1.901–2(a)(2)(i) and §1.903–1(a). Where a person claims credit under section 901 or 903 for an amount paid by a dual capacity taxpayer pursuant to a foreign levy, §1.901–2(a)(2)(i) and §1.903–1(a), respectively, require such person to establish the amount, if any, that is paid pursuant to the distinct element of the levy that is a tax. If, pursuant to paragraph (a)(1) of this section and §1.901–2(d), such levy as applicable to dual capacity taxpayers and such levy as applicable to other persons together constitute a single levy, then no amount paid pursuant to that levy by any such dual capacity taxpayer is considered to be paid in exchange for a specific economic benefit. Accordingly, such levy has only one distinct element, and the levy either is or is not, in its entirety, a tax. If, however, such levy as applicable to dual capacity taxpayers is a separate levy from such levy as applicable to other persons, then a person claiming credit under section 901 or 903 for an amount paid by a dual capacity taxpayer pursuant to such separate levy may establish the amount, if any, that is paid pursuant to the distinct element of the levy that is a tax only by the facts and circumstances method or the safe harbor method described in paragraph (c) of this section. If such person fails to so establish such amount, no portion of the amount that is paid pursuant to the separate levy by the dual capacity taxpayer to such foreign country shall be treated as an amount of tax. Any amount that, either by reason of application of the methods of paragraph (c) of this section or by reason of the immediately preceding sentence, is not treated as an amount of tax shall (i) be considered to have been paid in exchange for a specific economic benefit; (ii) be characterized (*e.g.*, as royalty, purchase price, cost of sales, reduction of the proceeds of a sale, or reduction of interest income) according to the nature of the transaction and of the specific economic benefit received; and (iii) be treated according to such characterization for all purposes of chapter 1 of the Internal Revenue Code, except that any determination that an amount is not tax for purposes of section 901 or 903 by reason of application of the safe harbor method shall not be taken into account in determining whether or not such an amount is to be characterized and treated as tax for purposes of computing an allowance for percentage depletion under sections 611 and 613.

(2) *Effect of certain treaties.* If, irrespective of whether such credit would be allowable under section 901 or 903 in the absence of a treaty, the United States has in force a treaty with a foreign country that treats a foreign levy as an income tax for purposes of allowing credit for United States tax and if the person claiming credit is entitled to the benefit of such treaty, then, unless such person claims credit not under the treaty but under section 901 or 903, and except to the extent the treaty provides otherwise and subject to all terms, conditions and limitations provided in the treaty, no portion of an amount paid with respect to such levy by a dual capacity taxpayer shall be considered to be paid in exchange for a specific economic benefit. If, however, such person claims credit not under such treaty but rather under section 901 or 903 (*e.g.*, so as not to be subject to a limitation contained in such treaty), the provisions of this section apply to such levy.

(c) *Satisfaction of burden of proof*—(1) *In general.* This paragraph (c) sets out the methods by which a person who claims credit under section 901 or 903 for an amount paid by a dual capacity taxpayer pursuant to a foreign levy that satisfies all of the criteria of section 901 or 903 other than the determination of the distinct element of the levy that is a tax and of the amount that is paid pursuant to that distinct element (a ''qualifying levy'') may establish such distinct element and amount. Such person must establish the amount paid pursuant to a qualifying levy that is paid pursuant to the distinct element of the levy that is a tax (which amount therefore is an amount of income tax within the meaning of §1.901–2(a)(1) or an amount of tax in lieu of income tax within the meaning of §1.903–1(a) (a ''qualifying amount'')) only by the facts and circumstances method set forth in paragraph (c)(2) of this section or the safe harbor method set forth in paragraph (c)(3) of this section. A levy is not a qualifying levy, and neither the facts and circumstances method nor the safe harbor method applies to an amount paid by a dual capacity taxpayer pursuant to a foreign levy, if it has been established pursuant to §1.901–2(d) and paragraph (a)(1) of this section that that levy as applied to that dual capacity taxpayer and that levy as applied to persons other than dual capacity taxpayers together constitute a single levy, or if it has been established in accordance with the first sentence of paragraph (b)(2) of this section that credit is allowable by reason of a treaty for an amount paid with respect to such levy.

(2) *Facts and circumstances method*—(i) *In general.* If the person claiming credit establishes, based on all of the relevant facts and circumstances, the amount, if any, paid by the dual capacity taxpayer pursuant to the qualifying levy that is not paid in exchange for a specific economic benefit, such amount is the qualifying amount with respect to such qualifying levy. In determining the qualifying amount with respect to a qualifying levy under the facts and circumstances method, neither the methodology nor the results that would have obtained if a person had elected to apply the safe harbor method to such qualifying levy is a relevant fact or circumstance. Accordingly, neither such methodology nor such results shall be taken into account in applying the facts and circumstances method.

(ii) *Examples.* The application of the facts and circumstances method is illustrated by the following examples:

Example 1. Country A, which does not have a generally imposed income tax, imposes a levy, called the country A income tax, on corporations that carry on the banking business through a branch in country A. All such corporations lend money to the government of country A, and the consideration (interest) paid by the government of country A for the loans is not made available by the government on substantially the same terms to the population of country A in general. Thus, the country A income tax is imposed only on dual capacity taxpayers. *L*, a corporation that carries on the banking business through a branch in country A and that is a dual capacity taxpayer, establishes that all of the criteria of section 901 are satisfied by the country A income tax, except for the determination of the distinct element of the levy that is a tax and of *L*'s qualifying amount with respect thereto. The country A income tax is, therefore, a qualifying levy. *L* establishes that, although all persons subject to the country A income tax are dual capacity taxpayers, the country A income tax applies in the same manner to income from such persons' transactions with the government of country A as it does to income from their transactions with private persons; that there are significant transactions (either in volume or in amount) with private persons; and that the portion of such persons' income that is derived from transactions with the government of country A on the one hand or private persons on the other varies greatly among persons subject to the country A income tax. By making this showing, *L* has demonstrated that no portion of the amount paid by it to country A pursuant to the levy is paid in exchange for a specific economic benefit (the interest income). Accordingly, *L* has demonstrated under the facts and circumstances method that the entire amount it has paid pursuant to the country A income tax is a qualifying amount.

Example 2. A, a domestic corporation that is a dual capacity taxpayer subject to a qualifying levy of country X, pays 1000u (units of country X currency) to country X in 1986 pursuant to the qualifying levy. *A* does not elect to apply the safe harbor method to country X, but if it had so elected, 800u would have been *A's* qualifying amount with respect to the levy. Based on all of the relevant facts and circumstances (which do not include either the methodology of the safe harbor method or the qualifying amount that would have obtained under that method), *A* establishes that 628u of such 1000u is not paid in exchange for a specific economic benefit. *A* has demonstrated under the facts and circumstances method that 628u is a qualifying amount. Pursuant to paragraph (b)(1) of this section, 372u (1000u–628u) is considered to have been paid by *A* in exchange for a specific economic benefit. That amount is characterized and treated as provided in paragraph (b)(1) of this section.

Example 3. The facts are the same as in example 2 except that under the safe harbor method 580u would have been *A*'s qualifying amount with respect to the levy. That amount is not a relevant fact or circumstance and the result is the same as in example 2.

(3) *Safe harbor method.* Under the safe harbor method, the person claiming credit makes an election as provided in paragraph (d) of this section and, pursuant to such election, applies the safe harbor formula described in paragraph (e) of this section to the qualifying levy or levies to which the election applies.

(d) *Election to use the safe harbor method*—(1) *Scope of election.* An election to use the safe harbor method is made with respect to one or more foreign states and possessions of the United States with respect to a taxable year of the person making the election (the ''electing person''). Such election applies to such taxable year and to all subsequent taxable years of the electing person (''election years''), unless the election is revoked in accordance with paragraph (d)(4) of this section. If an election applies to a foreign state or possession of the United States (''elected country''), it applies to all qualifying levies of the elected country and to all qualifying levies of all political subdivisions of the elected country with respect to which the electing person claims credit for amounts paid (or deemed to be paid) by any dual capacity taxpayer. A member of an affiliated group that files a consolidated United States income tax return may use the safe harbor method for a foreign state or U.S. possession only if an election to use the safe harbor method for that state or possession has been made by the common parent of such affiliated group on behalf of all members of the group. Similarly, a member of an affiliated group that does not file a consolidated United States income tax return may elect to use the safe harbor method for a foreign state or U.S. possession only if an election to use the safe harbor method for that state or possession is made by each member of the affiliated group which claims credit for taxes paid to such state or possession or to any political subdivision thereof. An election to use the safe harbor method for an elected country does not apply to foreign taxes carried back or forward to any election year from any taxable year to which the election does not apply. Such election does apply to foreign taxes carried back or forward from any election year to any taxable year. A person who elects to use the safe harbor method for one or more foreign countries may, in a later taxable year, also elect to use that method for other foreign countries.

(2) *Effect of election.* An election to use the safe harbor method described in paragraph (c)(3) of this section requires the electing person to apply the safe harbor formula of paragraph (e) of this section to all qualifying levies of all elected countries and their political subdivisions, and constitutes a specific waiver by such person of the right to use the facts and circumstances method described in paragraph (c)(2) of this section with respect to any levy of any elected country or any political subdivision thereof.

(3) *Time and manner of making election*—(i) *In general.* To elect to use the safe harbor method, an electing person must attach a statement to its United States income tax return for the taxable year for which the election is made and must file such return by the due date (including extensions) for the filing thereof. Such statement shall state—

(A) That the electing person elects to use the safe harbor method for the foreign states and the possessions of the United States designated in the statement and their political subdivisions, and

(B) That the electing person waives the right, for any election year, to use the facts and circumstances method for any levy of the designated states, possessions and political subdivisions. Notwithstanding the foregoing, a person may, with the consent of the Commissioner, elect to use the safe harbor method for a taxable year for one or more foreign states or possessions of the United States, at a date later than that specified in the first sentence of this paragraph (d)(3)(i), *e.g.*, upon audit of such person's United States income tax return for such taxable year. The Commissioner will normally consent to such a later election if such person demonstrates that it failed to make a timely election for such a foreign state or possession for such taxable year because such person reasonably believed either that it was not a dual capacity taxpayer with respect to such state or possession or that no levy that it paid to such state or possession or any political subdivision thereof was a qualifying levy (for example, because it reasonably, but incorrectly, believed that the levy it paid was not a separate levy from that applicable to persons other than dual capacity taxpayers). The Commissioner will not, however, consent to such a later election with respect to any state or possession for a taxable year if such person (or any other member of an affiliated group of which such person is a member) applied the facts and circumstances method to any levy of such state or possession or any political subdivision thereof for such taxable year.

(ii) Certain retroactive elections. Notwithstanding the requirements of paragraph (d)(3)(i) of this section relating to the time and manner of making an election, an election may be made for a taxable year beginning on or before November 14, 1983, provided the electing person elects in accordance with §1.901–2(h) to apply all of the provisions of this section, §1.901–2 and §1.903–1 to such taxable year and provided all of the requirements set forth in this paragraph (d)(3)(ii) are satisfied. Such an election shall be made by timely (including extensions) filing a federal income tax return or an amended federal income tax return for such taxable year; by attaching to such return a statement containing the statements and information set forth in paragraph (d)(3)(i) of this section; and by filing amended income tax returns for all subsequent election years for which income tax returns have previously been filed in which credit is claimed under section 901 or 903 and applying the safe harbor method in such amended returns. All amended returns referred to in the immediately preceding sentence must be filed on or before October 12, 1984, (unless the Commissioner consents to a later filing in circumstances similar to those provided in paragraph (d)(3)(i)) and at a time when neither assessment of a deficiency for any of such election years nor the filing of a claim for any refund claimed in any such amended return is barred.

(iii) *Election to credit taxes made in amended return.* If a person has filed a United States income tax return for a taxable year to which this §1.901–2A applies (including application by reason of the election provided in §1.901–2(h)(2)) in which such person has deducted (instead of credited) qualifying foreign taxes and such person validly makes an election to credit (instead of deduct) such taxes in a timely filed amended return for such taxable year, an election to use the safe harbor method may be made in such amended return provided all of the requirements of paragraph (d)(3)(ii) of this section are satisfied other than the requirement that such amended return and the other amended returns referred to in that paragraph be filed on or before October 12, 1984.

(4) *Revocation of election.* An election to use the safe harbor method described in paragraph (c)(3) of this section may not be revoked without the consent of the Commissioner. An application for consent to revoke such election with respect to one or more elected countries shall be made to the Commissioner of Internal Revenue, Washington, DC 20224. Such application shall be made not later than the 30th day before the due date (including extensions) for the filing of the income tax return for the first taxable year for which the revocation is sought to be effective, except in the case of an event described in (i), (ii), (iii) or (iv) below, in which case an application for revocation with retroactive effect may be made within a reasonable time after such event. The Commissioner may make his consent to any revocation conditioned upon adjustments being made in one or more taxable years so as to prevent the revocation from resulting in a distortion of the amount of any item relating to tax liability in any taxable year. The Commissioner will normally consent to a revocation (including, in the case of (i), (ii), (iii) or (iv) below, one with retroactive effect), if—

(i) An amendment to the Internal Revenue Code or the regulations thereunder is made which applies to the taxable year for which the revocation is to be effective and the amendment substantially affects the taxation of income from sources outside the United States under subchapter N of chapter 1 of the Internal Revenue Code; or

(ii) After a safe harbor election is made with respect to a foreign state, a tax treaty between the United States and that state enters into force; that treaty covers a foreign tax to which the safe harbor election applies; and that treaty applies to the taxable year for which the revocation is to be effective; or

(iii) After a safe harbor election is made with respect to a foreign state or possession of the United States, a material change is made in the tax law of that state or possession or of a political subdivision of that state or possession; and the changed law applies to the taxable year for which the revocation is to be effective and has a material effect on the taxpayer; or

(iv) With respect to a foreign country to which a safe harbor election applies, the Internal Revenue Service issues a letter ruling to the electing person and that letter ruling (*A*) relates to the availability or application of the safe harbor method to one or more levies of such foreign country; (*B*) does not relate to the facts and circumstances method described in paragraph (c)(2) of this section; and (*C*) fails to include a ruling requested by the electing person or includes a ruling contrary to one requested by such person (in either case, other than one relating to the facts and circumstances method) and such failure or inclusion has a material adverse effect on the amount of such electing person's credit for taxes paid to such foreign country for the taxable year for which the revocation is to be effective; or

(v) A corporation (''new member'') becomes a member of an affiliated group; the new member and one or more pre-existing members of such group are dual capacity taxpayers with respect to the same foreign country; and, with respect to such country, either the new member or the pre-existing members (but not both) have made a safe harbor election; and the Commissioner in his discretion determines that obtaining the benefit of the right to revoke the safe harbor election with respect to such foreign country was not the principal purpose of the affiliation between such new member and such group; or

(vi) The election has been in effect with respect to at least three taxable years prior to the taxable year for which the revocation is to be effective.

The Commissioner may, in his discretion, consent to a revocation even if none of the foregoing subdivisions (i) through (vi) is applicable. If an election has been revoked with respect to an elected country, a subsequent election to apply the safe harbor method with respect to such elected country may be made only with the consent of the Commissioner and upon such terms and conditions as the Commissioner in his discretion may require.

(e) *Safe harbor formula*—(1) *In general*. The safe harbor formula applies to determine the distinct element of a qualifying levy that is a tax and the amount paid by a dual capacity taxpayer pursuant to such qualifying levy that is the qualifying amount with respect to such levy. Under the safe harbor formula the amount paid in a taxable year pursuant to a qualifying levy that is the qualifying amount with respect to such levy is an amount equal to:

$$(A-B-C)\times D/(1-D)$$

where (except as otherwise provided in paragraph (e)(5) of this section):

A=the amount of gross receipts as determined under paragraph (e)(2) of this section

B=the amount of costs and expenses as determined under paragraph (e)(2) of this section

C=the total amount paid in the taxable year by the dual capacity taxpayer pursuant to the qualifying levy (the ''actual payment amount'')

D=the tax rate as determined under paragraph (e)(3) of this section

In no case, however, shall the qualifying amount exceed the actual payment amount; and the qualifying amount is zero if the safe harbor formula yields a qualifying amount less than zero. The safe harbor formula is intended to yield a qualifying amount that is approximately equal to the amount of generally imposed income tax within the meaning of paragraphs (a) and (b)(1) of §1.903–1 (''general tax'') of the foreign country that would have been required to be paid in the taxable year by the dual capacity taxpayer if it had not been a dual capacity taxpayer and if the base of the general tax had allowed a deduction in such year for the amount (''specific economic benefit amount'') by which the actual payment amount exceeds the qualifying amount. See, however, paragraph (e)(5) of this section if an elected country has no general tax. The specific economic benefit amount is considered to be the portion of the actual payment amount that is paid pursuant to the distinct portion of the qualifying levy that imposes an obligation in exchange for a specific economic benefit. The specific economic benefit amount is therefore considered to be an amount paid by the dual capacity taxpayer in exchange for such specific economic benefit, which amount must be treated for purposes of chapter 1 of the Internal Revenue Code as provided in paragraph (b)(1) of this section.

(2) *Determination of gross receipts and costs and expenses.* For purposes of the safe harbor formula, gross receipts and costs and expenses are, except as otherwise provided in this paragraph (e), the gross receipts and the deductions for costs and expenses, respectively, as determined under the foreign law applicable in computing the actual payment amount of the qualifying levy to which the safe harbor formula applies. However, except as otherwise provided in this paragraph (e), if provisions of the qualifying levy increase or decrease the liability imposed on dual capacity taxpayers compared to the general tax liability of persons other than dual capacity taxpayers by reason of the determination or treatment of gross receipts or of costs or expenses, the provisions generally applicable in computing such other persons' tax base under the general tax shall apply to determine gross receipts and costs and expenses for purposes of computing the qualifying amount. If provisions of the qualifying levy relating to gross receipts meet the requirements of §1.901–2(b) (3)(i), such provisions shall apply to determine gross receipts for purposes of computing the qualifying amount. If neither the general tax nor the qualifying levy permits recovery of one or more costs or expenses, and by reason of the failure to permit such recovery the qualifying levy does not satisfy the net income requirement of §1.901–2(b)(4) (even though the general tax does satisfy that requirement), then such cost or expense shall be considered a cost or expense for purposes of computing the qualifying amount. If the qualifying levy does not permit recovery of one or more significant costs or expenses, but provides allowances that effectively compensate for nonrecovery of such significant costs or expenses, then, for purposes of computing the qualifying amount, costs and expenses shall not include the costs and expenses under the general tax whose nonrecovery under the qualifying levy is compensated for by such allowances but shall instead include such allowances. In determining costs and expenses for purposes of computing the qualifying amount with respect to a qualifying levy, the actual payment amount with respect to such levy shall not be considered a cost or expense. For purposes of this paragraph, the following differences in gross receipts and costs and expenses between the qualifying levy and the general tax shall not be considered to increase the liability imposed on dual capacity taxpayers compared to the general tax liability of persons other than dual capacity taxpayers, but only if the general tax would be an income tax within the meaning of §1.901–2(a)(1) if such different treatment under the qualifying levy had also applied under the general tax:

(i) Differences in the time of realization or recognition of one or more items of income or in the time when recovery of one or more costs and expenses is allowed (unless the period of recovery of such costs and expenses pursuant to the qualifying levy is such that it effectively is a denial of recovery of such costs and expenses, as described in §1.901–2(b)(4)(i)); and

(ii) Differences in consolidation or carryover provisions of the types described in paragraphs (b)(4)(ii) and (b)(4)(iii) of §1.901–2.

(3) *Determination of tax rate.* The tax rate for purposes of the safe harbor formula is the tax rate (expressed as a

decimal) that is applicable in computing tax liability under the general tax. If the rate of the general tax varies according to the amount of the base of that tax, the rate to be applied in computing the qualifying amount is the rate that applies under the general tax to a person whose base is, using the terminology of paragraph (e)(1) of this section, ''A'' minus ''B'' minus the specific economic benefit amount paid by the dual capacity taxpayer pursuant to the qualifying levy, provided such rate applies in practice to persons other than dual capacity taxpayers, or, if such rate does not so apply in practice, the next lowest rate of the general tax that does so apply in practice.

(4) *Determination of applicable provisions of general tax*—(i) *In general.* If the general tax is a series of income taxes (*e.g.*, on different types of income), or if the application of the general tax differs by its terms for different classes of persons subject to the general tax (*e.g.*, for persons in different industries), then, except as otherwise provided in this paragraph (e), the qualifying amount small be computed by reference to the income tax contained in such series of income taxes, or in the case of such different applications the application of the general tax, that by its terms and in practice imposes the highest tax burden on persons other than dual capacity taxpayers. Notwithstanding the preceding sentence, the general tax amount shall be computed by reference to the application of the general tax to entities of the same type (as determined under the general tax) as the dual capacity taxpayer and to persons of the same resident or nonresident status (as determined under the general tax) as the dual capacity taxpayer; and, if the general tax treats business income differently from nonbusiness (*e.g.*, investment) income (as determined under the general tax), the dual capacity taxpayer's business and non-business income shall be treated as the general tax treats such income. If, for example, the dual capacity taxpayer would, under the general tax, be treated as a resident (*e.g.*, because the general tax treats an entity that is organized in the foreign country or managed or controlled there as a resident) and as a corporation (*i.e.*, because the rules of the general tax treat an entity like the dual capacity taxpayer as a corporation), and if some of the dual capacity taxpayer's income would, under the general tax, be treated as business income and some as non-business income, the dual capacity taxpayer and its income shall be so treated in computing the qualifying amount.

(ii) *Establishing that provisions apply in practice.* For purposes of the safe harbor formula a provision (including tax rate) shall be considered a provision of the general tax only if it is reasonably likely that that provision applies by its terms and in practice to persons other than dual capacity taxpayers. In general, it will be assumed that a provision (including tax rate) that by its terms applies to persons other than dual capacity taxpayers is reasonably likely to apply in practice to such other persons, unless the person claiming credit knows or has reason to know otherwise. However, in cases of doubt, the person claiming credit may be required to demonstrate that such provision is reasonably likely so to apply in practice.

(5) *No general tax.* If a foreign country does not impose a general tax (and thus a levy, in order to be a qualifying levy must satisfy all of the criteria of section 901 (because section 903 cannot apply), other than the determination of the distinct element of the levy that is a tax and of the amount that is paid pursuant to that distinct element), paragraphs (e)(2), (3) and (4) of this section do not apply to a qualifying levy of such country, and the terms of the safe harbor formula set forth in paragraph (e)(1) of this section are defined with respect to such levy as follows:

A=the amount of gross receipts as determined under the qualifying levy;

B=the amount of deductions for costs and expenses as determined under the qualifying levy;

C=the actual payment amount; and

D=the lower of the rate of the qualifying levy, or the rate of tax specified in section 11(b)(5) (or predecessor or successor section, as the case may be) of the Internal Revenue Code as applicable to the taxable year in which the actual payment amount is paid.

(6) *Certain taxes in lieu of an income tax.* To the extent a tax in lieu of an income tax (within the meaning of §1.903–1(a)) that applies in practice to persons other than dual capacity taxpayers would actually have been required to be paid in the taxable year by a dual capacity taxpayer if it had not been a dual capacity taxpayer (*e.g.*, in substitution for the general tax with respect to a type of income, such as interest income, dividend income, royalty income, insurance income), such tax in lieu of an income tax shall be treated as if it were an application of the general tax for purposes of applying the safe harbor formula of this paragraph (e) to such dual capacity taxpayer, and such formula shall be applied to yield a qualifying amount that is approximately equal to the general tax (so defined) that would have been required to be paid in the taxable year by such dual capacity taxpayer if the base of such general tax had allowed a deduction in such year for the specific economic benefit amount.

(7) *Multiple levies.* If, in any election year of an electing person, with respect to any elected country and all of its political subdivisions,

(i) Amounts are paid by a dual capacity taxpayer pursuant to more than one qualifying levy or pursuant to one or more levies that are qualifying levies and one or more levies that are not qualifying levies by reason of the last sentence of paragraph (c)(1) of this section but with respect to which credit is allowable, or

(ii) More than one general tax (including a tax treated as if it were an application of the general tax under paragraph (e)(6)) would have been required to be paid by a dual capacity taxpayer (or taxpayers) if it (or they) had not been a dual capacity taxpayer (or taxpayers), or

(iii) Credit is claimed with respect to amounts paid by more than one dual capacity taxpayer,

the provisions of this paragraph (e) shall be applied such that the aggregate qualifying amount with respect to such qualifying levy or levies plus the aggregate amount paid with respect to levies referred to in (e)(7)(i) that are not qualifying levies shall be the aggregate amount that would have been required to be paid in the taxable year by such dual capacity taxpayer (or taxpayers) pursuant to such general tax or taxes if it (or they) had not been a dual capacity taxpayer (or taxpayers) and if the base of such general tax or taxes had allowed a deduction in such year for the aggregate specific economic benefit amount (except that, if paragraph (e)(5) applies to any levy of such elected country or any political subdivision thereof, the aggregate qualifying amount for qualifying levies of such elected country and all of its political subdivisions plus the aggregate amount paid with respect to levies referred to in paragraph (e)(7)(i) that are not qualifying levies shall not exceed the greater of the aggregate amount paid with respect to levies referred to in paragraph (e)(7)(i) that are not qualifying levies and the amount determined in accordance with paragraph (e)(5) where ''D'' is the rate of tax specified in section 11(b)(5) (or predecessor or successor section, as the case may be) of the Internal Revenue Code as applicable to the taxable year in which the actual payment amount is paid). However, in no event shall such aggregate amount exceed the aggregate actual payment amount plus the aggregate amount paid with respect to levies referred to in (e)(7)(i) that are not qualifying levies, nor be less than the aggregate amount paid with respect to levies referred to in (e)(7)(i) that are not qualifying levies. In applying (e)(7)(ii) a person who is not subject to a levy but who is considered to receive a specific economic benefit by reason of §1.901–2(a)(2)(ii)(E) shall be treated as a dual capacity taxpayer. See example 12 in paragraph (e)(8) of this section.

(8) *Examples.* The provisions of this paragraph (e) may be illustrated by the following examples:

Example 1. Under a levy of country X called the country X income tax, every corporation that does business in country X is required to pay to country X 40% of its income from its business in country X. Income for purposes of the country X income tax is computed by subtracting specified deductions from the corporation's gross income derived from its business in country X. The specified deductions include the corporation's expenses attributable to such gross income and allowances for recovery of the cost of capital expenditures attributable to such gross income, except that under the terms of the country X income tax a corporation engaged in the exploitation of minerals K, L or M in country X is not permitted to recover, currently or in the future, expenditures it incurs in exploring for those minerals. Under the terms of the country X income tax interest is not deductible to the extent it exceeds an arm's length amount (*e.g.*, if the loan to which the interest relates is not in accordance with normal commercial practice or to the extent the interest rate exceeds an arm's length rate). In practice, the only corporations that engage in exploitation of the specified minerals in country X are dual capacity taxpayers. Because no other persons subject to the levy engage in exploitation of minerals K, L or M in country X, the application of the country X income tax to dual capacity taxpayers is different from its application to other corporations. The country X income tax as applied to corporations that engage in the exploitation of minerals K, L or M (dual capacity taxpayers) is, therefore, a separate levy from the country X income tax as applied to other corporations.

A is a U.S. corporation that is engaged in country X in exploitation of mineral K. Natural deposits of mineral K in country X are owned by country X, and *A* has been allowed to extract mineral K in consideration of payment of a bonus and of royalties to an instrumentality of country X. Therefore, *A* is a dual capacity taxpayer. In 1984, *A* does business in country X within the meaning of the levy. *A* has validly elected the safe harbor method for country X for 1984. In 1984, as determined in accordance with the country X income tax as applied to *A, A* has gross receipts of 120u (units of country X currency), deducts 20u of costs and expenses, and pays 40u (40% of (120u–20u)) to country X pursuant to the levy. *A* also incurs in 1984 10u of nondeductible expenditures for exploration for mineral K and 2u of nondeductible interest costs attributable to an advance of funds from a related party to finance an undertaking relating to the exploration for mineral K for which normal commercial financing was unavailable because of the substantial risk inherent in the undertaking. *A* establishes that the country X income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1), that it is the generally imposed income tax of country X and hence the general tax, and that all of the criteria of section 903 are satisfied with respect to the country X income tax as applied to dual capacity taxpayers, except for the determination of the distinct element of the levy that is a tax and of *A*'s qualifying amount with respect thereto. (No conclusion is reached whether the country X income tax as applied to dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1). Such a determination would require, among other things, that the country X income tax as so applied, judged on the basis of its predominant character, meets the net income requirement of §1.901–2(b)(4) notwithstanding its failure to permit recovery of exploration expenses.) *A* has therefore demonstrated that the country X income tax as applied to dual capacity taxpayers is a qualifying levy.

In applying the safe harbor formula, in accordance with paragraph (e)(2), the amount of *A*'s costs and expenses includes the 10u of nondeductible exploration expenses. The failure to permit recovery of interest in excess of arm's length amounts, a provision of both the general tax and the qualifying levy, does not cause the qualifying levy to fail to satisfy the net income requirement of §1.901–2(b)(4); therefore, the amount of *A*'s costs and expenses does not include the 2u of nondeductible interest costs. Thus, under the safe harbor method, *A*'s qualifying amount with respect to the levy is 33.33u ((120u–30u–40u) × .40/(1–.40)). *A*'s specific economic benefit amount is 6.67u (*A*'s actual payment amount (40u) less *A*'s qualifying amount (33.33u)). Under paragraph (a) of this section, this 6.67u is considered to be consideration paid by *A* for the right to extract mineral K. Pursuant to paragraph (b) of this section, this amount is characterized according to the nature of *A*'s transactions with country X and its instrumentality and of the specific economic benefit received (the right to extract mineral K), as an additional royalty or other business expense paid or accrued by *A* and is so treated for all purposes of chapter 1 of the Internal Revenue Code, except that if an allowance for percentage depletion is allowable to *A* under sections 611 and 613 with respect to *A*'s interest in mineral K, the determination whether this 6.67u is tax or royalty for purposes of computing the amount of such allowance shall be made under sections 611 and 613 without regard to the determination that under the safe harbor formula such 6.67u is not tax for purposes of section 901 or 903.

Example 2. Under a levy of country Y called the country Y income tax, each corporation incorporated in country Y is required to pay to country Y a percentage of its worldwide income. The applicable percentage is 40 percent of the first 1,000u (units of country Y currency) of income and 50 percent of income in excess of 1,000u. Income for purposes of the levy is computed by deducting from gross income specified types of expenses and specified allowances for capital expenditures. The expenses for which deductions are permitted differ depending on the type of business in which the corporation subject to the levy is engaged, *e.g.*, a deduction for interest paid to a related party is not allowed for corporations engaged in enumerated types of activities. In addition, carryover of losses from one taxable period to another is permitted for corporations engaged in specified types of activities, but not for corporations engaged in other activities. By its terms, the foreign levy makes no distinction between dual capacity taxpayers and other persons. In practice the differences in the base of the country Y income tax (*e.g.*, the lack of a deduction for interest paid to related parties for some corporations subject to the levy and the lack of a carryover provision for some corporations subject to the levy) apply to both dual capacity taxpayers and other persons, but the 50 percent rate applies only to dual capacity taxpayers. By reason of such higher rate, application of the country Y income tax to dual capacity taxpayers is different in practice from application of the country Y income tax to other persons subject to it. The country Y income tax as applied to dual capacity taxpayers is therefore a separate levy from the country Y income tax as applied to other corporations incorporated in country Y.

B is a corporation incorporated in country Y that is engaged in construction activities in country Y. *B* has a contract with the government of country Y to build a hospital in country Y for a fee that is not made available on substantially the same terms to substantially all persons who are subject to the general tax of country X. Accordingly, *B* is a dual capacity taxpayer. *B* has validly elected the safe harbor method for country Y for 1985. In 1985, as determined in accordance with the country Y income tax as applied to *B*, *B* has gross receipts of 10,000u, deducts 6,000u of costs and expenses, and pays 1900u ((1,000u×40%) + (3,000u×50%)) to country Y pursuant to the levy.

It is asssumed that *B* has established that the country Y income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1) and is the general tax. It is further assumed that *B* has demonstrated that all of the criteria of section 901 are satisfied with respect to the country Y income tax as applied to dual capacity taxpayers, except for the determination of the distinct element of such levy that is a tax and of *B*'s qualifying amount with respect to that levy, and therefore that the country Y income tax as applied to dual capacity taxpayers is a qualifying levy.

In applying the safe harbor formula, in accordance with paragraph (e)(3), the 50 percent rate is not used because it does not apply in practice to persons other than dual capacity taxpayers. The next lowest rate of the general tax that does apply in practice to such persons, 40 percent, is used. Accordingly, under the safe harbor formula, *B*'s qualifying amount with respect to the levy is 1400u ((10,000u–6000u–1900u) × .40/(1–.40)). *B*'s specific economic benefit amount is 500u (B's actual payment amount (1900u) less *B*'s qualifying amount (1400u)). Pursuant to paragraph (b) of this section, *B*'s specific economic benefit amount is characterized according to the nature of *B*'s transactions with country Y and of the specific economic benefit received, as a reduction of *B*'s proceeds of its contract with country Y; and this amount is so treated for all purposes of chapter 1 of the Code, including the computation of *B*'s accumulated profits for purposes of section 902.

Example 3. The facts are the same as in example 2, with the following additional facts: The contract between *B* and country Y is a cost plus contract. One of the costs of the contract which country Y is required to pay or for which it is required to reimburse *B* is any tax of country Y on *B*'s income or receipts from the contract. Instead of reimbursing *B* therefor, country Y agrees with *B* to assume any such tax liability. Under country Y tax law, *B* is not considered to have additional income or receipts by reason of country Y's assumption of *B*'s country Y tax liability. In 1985, *B*'s gross receipts of 10,000u include 3000u from the contract, and its costs and expenses of 6000u include 2000u attributable to the contract. *B*'s other gross receipts and expenses do not relate to any transaction in which B receives a specific economic benefit. In accordance with the contract, country Y, and not *B*, is required to bear the amount of *B*'s country Y income tax liability on *B*'s 1000u (3000u–2000u) income from the contract. In accordance with the contract *B* computes its country Y income tax without taking this 1000u into account and therefore pays 1400u ((1000u × 40%) + (2000u × 50%)) to country Y pursuant to the levy.

In accordance with §1.901–2(f)(2)(i), the country Y income tax which country Y is, under the contract, required to bear is considered to be paid by country Y on behalf of *B*. *B*'s proceeds of its contract, for all purposes of chapter 1 of the Code (including the computation of *B*'s accumulated profits for purposes of section 902), therefore, are increased by the additional 500u (1900u computed as in example 2 less 1400u as computed above) of *B's* liability under the country Y income tax that is assumed by country Y and such 500u is considered to be paid pursuant to the levy by country Y on behalf of *B*. In applying the safe harbor formula, therefore, the computation is exactly as in example 2 and the results are the same as in example 2.

Example 4. Country L issues a decree (the ''April 11 decree''), in which it states it is exercising its tax authority to impose a tax on all corporations on their ''net income'' from country L. ''Net income'' is defined as actual gross receipts less all expenses attributable thereto, except that in the case of income from extraction of petroleum, gross receipts are defined as 105 percent of actual gross receipts, and no deduction is allowed for interest incurred on loans whose proceeds are used for exploration for petroleum. Under the April 11 decree, wages paid by corporations subject to the decree are deductible in the year of payment, except that corporations engaged in the extraction of petroleum may deduct such wages only by amortization over a 5-year period and, to the extent such wages are paid to officers, they may be deducted only by amortization over a period of 50 years. The April 11 decree permits related corporations subject to the decree to file consolidated returns in which net income and net losses of related corporations offset each other in computing net income for purposes of the April 11 decree, except that corporations engaged in petroleum exploration or extraction activities are not eligible for inclusion in such a consolidated return. The law of country L does not require separate entities to carry on separate activities in connection with exploring for or extracting petroleum. Net losses of a taxable year may be carried over for 10 years to offset income, except that no more than 25% of net income (before deducting the loss carryover) in any such future year may be offset by a carryover of net loss, and, in the case of any corporation engaged in exploration or extraction of petroleum, losses incurred prior to such a corporation's having net income from production may be carried forward for only 8 years and no more than 15% of net income in any such future year may be offset by such a net loss. The rate to be paid under the April 11 decree is 50% of net income (as defined in the levy), except that if net income exceeds 10,000u (units of country L currency), the rate is 75% of the corporation's net income (including the first 10,000u thereof). In practice, no corporations other than corporations engaged in extraction of petroleum have net income in excess of 10,000u. All petroleum resources of country L are owned by the government of country L, whose petroleum ministry licenses corporations to explore for and extract petroleum in consideration for payment of royalties as petroleum is produced.

J is a U.S. corporation that is engaged in country L in the exploration and extraction of petroleum and therefore is a dual capacity taxpayer. *J* has validly elected the safe harbor method for country L for the year 1983, the year that *J* commenced activities in country L, and has not revoked such election. For the years 1983 through 1986, *J*'s gross receipts, deductions and net income before application of the carryover provisions, determined in accordance with the April 11 decree, are as follows:

Year	Gross receipts (105 percent of actual gross receipts)	Deductions other than wages	Wages paid other than to officers (amortizable at 20 percent)	Wages paid to officers (amortizable at 2 percent)	Nondeductible exploration interest expense	Net income (loss) (B–C–amortization of cumulative D-amortization of cumulative E)
A.	B.	C.	D.	E.	F.	G.
1983	0	13,000u	100u	50u	1,000u	(13,021u)
1984	0	17,000u	100u	50u	2,800u	(17,042u)
1985	42,000u	15,000u	100u	50u	2,800u	26,937u
1986	105,000u	20,000u	100u	50u	2,800u	84,916u

After application of the carryover provisions, *J*'s net income and actual payment amounts pursuant to the April 11 levy are as follows:

Year	Net income (loss)	Actual payment amount (*I* × 75 percent)
H.	*I.*	*J.*
1983	(13,021u)	0
1984	(17,042u)	0
1985	22,896u	17,172u
1986	72,179u	54,134u

Pursuant to paragraph (a)(1) of this section, the April 11 decree as applied to corporations engaged in the exploration or extraction of petroleum in country L is a separate levy from the April 11 decree as applied to all other corporations. *J* establishes that the April 11 decree, as applied to such other corporations, is an income tax within the meaning of §1.901–2(a)(1) and that the decree as so applied is the general tax.

The April 11 decree as applied to corporations engaged in the exploration or extraction of petroleum in country L does not meet the gross receipts requirement of §1.901–2(b)(3); therefore, irrespective of whether it meets the other requirements of §1.901–2(b)(1), it is not an income tax within the meaning of §1.901–2(a)(1). However, the April 11 decree as applied to such corporations is a qualifying levy because *J* has demonstrated that all of the criteria of section 903 are satisfied with respect to the April 11 decree as applied to such corporations, except for the determination of the distinct element of such levy that imposes a tax and of *J*'s qualifying amount with respect thereto.

In applying the safe harbor formula, in accordance with paragraph (e)(2), gross receipts are computed by reference to the general levy, and thus are 100%, not 105%, of actual gross receipts. Similarly, costs and expenses include exploration interest expense. In accordance with paragraph (e)(2)(i) of this section the difference between the general tax and the qualifying levy in the timing of the deduction for wages, other than wages of officers, is not considered to increase the liability of dual capacity taxpayers because the general tax would not have failed to be an income tax within the meaning of § 1.901–2(a)(1) if it had provided for 5-year amortization of such wages instead of for current deduction. *See* § 1.901–2(b)(4)(i). However, amortization of wages paid to officers over a 50-year period is such a deferred recovery of such wages that it effectively is a denial of the deduction of the excess of such wages paid in any year over the amortization of such cumulative wages permitted in such year. See § 1.901–2(b)(4)(i). The different treatment of wages paid to officers under the general tax and the qualifying levy is thus not merely a difference in timing within the meaning of paragraph(e)(2)(i) of this section. Accordingly, the difference between the amount of wages paid by *J* to officers in any year and *J*'s deduction (in computing the actual payment amount) for amortization of such cumulative wages allowed in such year is, pursuant to paragraph (e)(2) of this section, treated as a cost and expense in computing *J*'s qualifying amount for such year with respect to the April 11 decree. The differences in the consolidation and carryover provisions between the general tax and the qualifying levy are of the types described in paragraph (e)(2)(ii) of this section and, pursuant to paragraphs (b)(4)(ii) and (b)(4)(iii) of § 1.901–2, the general tax would not fail to be an income tax within the meaning of § 1.901–2(a)(i) even if it contained the consolidation and carryover provisions of the qualifying levy. Thus, such differences are not considered to increase the liability of dual capacity taxpayers pursuant to the qualifying levy as compared to the general tax liability of persons other than dual capacity taxpayers.

Accordingly, in applying the safe harbor formula to the qualifying levy for 1985 and 1986, gross receipts and costs and expenses are computed as follows:

Gross receipts

1985: 42,000u × (100/105)=40,000u
1986: 105,000u × (100/105)=100,000u

COSTS AND EXPENSES

Item	1985	1986
1. Deductions other than wages (column C in the preceding chart)	15,000u	20,000u
2. Amortization of cumulative wages paid in 1983 and thereafter other than to officers	60u	80u
3. Deduction of wages to officers paid in current year, instead of amortization allowed in current year of such cumulative wages paid in 1983 and thereafter	50u	50u
4. Deduction of exploration interest expense	2,800u	2,800u
5. Costs and expenses before carryover of net loss (sum of lines 1 through 4)	17,910u	22,930u
6. Recalculation of loss carryover by recalculating 1983 and 1984 net income (loss) to reflect current deduction of wages to officers and exploration interest expense: 1983 adjusted net loss carryover: (13,021u) + (49u) + (1000u)=(14,070u); 1984 adjusted net loss carryover: (17,042u) + (48u) + (2800u)=(19,890u).		
7. Recalculation of limitation on use of net loss carryover deduction:		
Gross receipts	40,000u	100,000u
Less costs and expenses	(17,910u)	(22,930)
Total	22,090u	77,070u
Times 15 percent limitation	3,314u	11,561u
8. Costs and expenses including net loss carryover deduction (line 5 plus line 7)	21,224u	34,491u

In years after 1986, costs and expenses for purposes of determining the qualifying amount would reflect net loss carryforward deductions based on the recomputed losses carried forward from 1983 and 1984 (14,070u and 19,890u, respectively) less the amounts thereof that were utilized in determining costs and expenses for 1985 and 1986 (3,314u and 11,561u, respectively). The 1983 and 1984 loss carryforwards would be considered utilized in accordance with the order of priority in which such losses are utilized under the terms of the qualifying levy.

In applying the safe harbor formula, the tax rate to be used, in accordance with paragraph (e)(3) of this section, is .50.

Accordingly, under the safe harbor method, *J*'s qualifying amounts with respect to the April 11 decree for 1985 and 1986 are computed as follows:

1985: (40,000u–21,224u–17,172u) × .50/(1–.50)=1604u

1986: (100,000u–34,491u–54,134u) × .50/(1–.50)=11,375u

Under the safe harbor method *J*'s qualifying amounts with respect to the April 11 decree for 1985 and 1986 are thus 1604u and 11,375u, respectively; and its specific economic benefit amounts are 15,568u (17,172u–1604u) and 42,759u, (54,134u–11,375u), respectively. Pursuant to paragraph (b) of this section, *J*'s specific economic benefit amounts are characterized according to the nature of *J*'s transactions with country L and of the specific economic benefit received by *J* as additional royalties paid to country L with respect to the petroleum extracted by *J* in country L in 1985 and 1986, and these amounts are so treated for all purposes of chapter 1 of the Code.

Example 5. Country E, which has no generally imposed income tax, imposes a levy called the country E income tax only on corporations carrying on the banking business through a branch in country E and on corporations engaged in the extraction of petroleum in country E. All of the petroleum resources of country E are owned by the government of country E, whose petroleum ministry licenses corporations to explore for and extract petroleum in consideration of payment of royalties as petroleum is extracted. The base of the country E income tax is a corporation's actual gross receipts from sources in country E less all expenses attributable, on reasonable principles, to such gross receipts; the rate of tax is 29 percent.

A is a U.S corporation that carries on the banking business through a branch in country E. *B* is a U.S. corporation (unrelated to *A*) that is engaged in the extraction of petroleum in country E. In 1984 *A* receives interest on loans it has made to 160 borrowers in country E, seven of which are agencies and instrumentalities of the government of country E. The economic benefits received by *A* and *B* (*i.e.*, the interest received by *A* from the government and B's license to extract petroleum owned by the government) are not made available on substantially the same terms to the population of country E in general.

A and *B* are dual capacity taxpayers. Each of them has validly elected the safe harbor method for country E for 1984. *A* demonstrates that the country E income tax as applied to it (a dual capacity taxpayer) is not different by its terms or in practice from the country E income tax as applied to persons (in this case other banks) that are not dual capacity taxpayers. *A* has therefore established pursuant to paragraph (a)(1) of this section and §1.901–2(d) that the country E income tax as applied to it and the country E income tax as applied to persons other than dual capacity taxpayers are together a single levy. *A* establishes that such levy is an income tax within the meaning of §1.901–2(a)(1). In accordance with paragraph (a)(1) of this section, no portion of the amount paid by *A* pursuant to such levy is considered to be paid in exchange for a specific economic benefit. Thus, the entire amount paid by *A* pursuant to this levy is an amount of income tax paid.

B does not demonstrate that the country E income tax as applied to corporations engaged in the extraction of petroleum in country E (dual capacity taxpayers) is not different by its terms or in practice from the country E income tax as applied to persons other than dual capacity taxpayers (*i.e.*, banks that are not dual capacity taxpayers). Accordingly, pursuant to paragraph (a)(1) of this section and §1.901–2(d), the country E income tax as applied to corporations engaged in the extraction of petroleum in country E is a separate levy from the country E income tax as applied to other persons.

B demonstrates that all of the criteria of section 901 are satisfied with respect to the country E income tax as applied to corporations engaged in the exploration of petroleum in country E, except for the determination of the distinct element of such levy that imposes a tax and of *B*' s qualifying amount with respect to the levy. Pursuant to paragraph (e)(5) of this section, in applying the safe harbor formula to *B*, ''A'' is the amount of *B*' s gross receipts as determined under the country E income tax as applied to *B*; ''B'' is the amount of *B*' s costs and expenses as determined thereunder; ''C'' is *B*' s actual payment amount; and ''D'' is .29, the lower of the rate (29 percent) of the qualifying levy (the country E income tax as applied to corporations engaged in the extraction of petroleum in country E) or the rate (46 percent) of tax specified for 1984 in section 11(b)(5) of the Internal Revenue Code. Thus, *B*' s qualifying amount is equal to its actual payment amount.

Example 6. The facts are the same as in example 5, except that the rate of the country E income tax is 55 percent. For the reasons stated in example 5, the results with respect to *A* are the same as in example 5. In applying the safe harbor formula to *B*, ''A,'' ''B,'' and ''C'' are the same as in example 5, but ''D'' is .46, as that rate is less than .55. Thus, *B*' s qualifying amount is less than *B*' s actual payment amount, and the difference is *B*' s specific economic benefit amount.

Example 7. Country E imposes a tax (called the country E income tax) on the realized net income derived by corporations from sources in country E, except that, with respect to interest income received from sources in country E and certain insurance income, nonresident corporations are instead subject to other levies. With respect to such interest income a levy (called the country E interest tax) requires nonresident corporations to pay to country E 20 percent of such gross interest income unless the nonresident corporation falls within a specified category of corporations (''special corporations''), all of which are dual capacity taxpayers, in which case the rate is instead 25 percent. With respect to such insurance income nonresident corporations are subject to a levy (called the country E insurance tax), which is not an income tax within the meaning of § 1.901–2(a)(1).

The country E interest tax applies at the 20 percent rate by its terms and in practice to persons other than dual capacity taxpayers. The country E interest tax as applied at the 25 percent rate to special corporations applies only to dual capacity taxpayers; therefore, the country E interest tax as applied to special corporations is a separate levy from the country E interest tax as applied at the 20 percent rate.

A is a U.S. corporation which is a special corporation subject to the 25 percent rate of the country E interest tax. *A* does not have any insurance income that is subject to the country E insurance tax. *A*, a dual capacity taxpayer, has validly elected the safe harbor formula for 1984. In 1984 *A* receives 100u (units of country E currency) of gross interest income subject to the country E interest tax and pays 25u to country E.

A establishes that the country E income tax is the generally imposed income tax of country E; that all of the criteria of section 903 are satisfied with respect to the country E interest tax as applied to special corporations except for the determination of the distinct element of the levy that is a tax and of *A*' s qualifying amount with respect thereto. *A* has therefore demonstrated that the country E interest tax as applied to special corporations is a qualifying levy. *A* establishes that the country E interest tax at the 20 percent rate is a tax in lieu of an income tax within the meaning of § 1.903–1(a). Pursuant to paragraph (e)(6) of this section the country E interest tax at the 20 percent rate is treated as if it were an application of the general tax for purposes of the safe harbor formula of this paragraph (e), since that tax would actually have been required to have been paid by *A* with respect to its interest income had *A* not been a dual capacity taxpayer (special corporation) instead subject to the qualifying levy (the country E interest tax at the 25 percent rate).

Even if the country E insurance tax is a tax in lieu of an income tax within the meaning of § 1.903–1(a), that tax is not treated as if it were an application of the general tax for purposes of applying the safe harbor formula to *A* since *A* had no insurance income in 1984 and hence such tax would not actually have been required to be paid by *A* had *A* not been a dual capacity taxpayer.

Example 8. Under a levy of country S called the country S income tax, each corporation operating in country S is required to pay country S 50 percent of its income from operations in country S. Income for purposes of the country S income tax is computed by subtracting all attributable costs and expenses from a corporation's gross receipts derived from its business in country S. Among corporations on which the country S income tax is imposed are corporations engaged in the exploitation of mineral K in country S. Natural deposits of mineral K in country S are owned by country S, and all corporations engaged in the exploitation thereof do so under concession agreement with an instrumentality of country S. Such corporations, in addition to the 50 percent country S income tax, are also subject to a levy called a surtax, which is equal to 60 percent of posted price net income less the amount of the contry S income tax. The surtax is not deductible in computing the country S income tax of corporations engaged in the exploitation of mineral K in country S.

A is a U.S. corporation engaged in country S in the exploitation of mineral K, and *A* has been allowed to extract mineral K under a concession agreement with an instrumentality of country S. Therefore, *A* is a dual capacity taxpayer. In accordance with a term of the concession agreement, certain of *A*'s income (net of expenses attributable thereto) is exempted from the income tax and surtax.

The results for *A* in 1984 are as follows:

	Income Tax	Surtax
Gross Receipts:		
Realized—Taxable	120u	—
Realized—Exempt	15u	—
Posted Price-Taxable	—	145u
Costs:		
Attributable to Taxable Receipts	20u	20u
Attributable to Exempt Receipts	5u	—
Taxable Income	100u	125u
Tentative Surtax (60 percent)	—	75u
Petroleum Levy at 50 percent	50u	50u
Surtax	—	25u

Because of the difference (nondeductibility of the surtax) in the country S income tax as applied to dual capacity taxpayers from its application to other persons, the country S income tax as applied to dual capacity taxpayers and the country S income tax as applied to persons other than dual capacity taxpayers are separate levies. Moreover, because *A*'s concession agreement provides for a modification (exemption of certain income) of the country S income tax and surtax as they otherwise apply to other persons engaged in the exploitation of mineral K in country S, those levies (contractual levies) as applied to *A* are separate levies from those levies as applied to other persons engaged in the exploitation of mineral K in country S.

A establishes that the country S income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of § 1.901–2(a)(1) and is the general tax. *A* demonstrates that all the criteria of section 903 are satisfied with respect to the country S income tax as applied to *A* and with respect to the surtax as applied to *A*, except for the determination of the distinct elements of such levies that are taxes and of *A'* s qualifying amounts with respect to such levies. Therefore, both the country S income tax as applied to *A* and the surtax as applied to *A* are qualifying levies.

In applying the safe harbor formula, in accordance with paragraph (e)(2), the amount of *A'* s gross receipts includes the exempt realized income, and the amount of *A'* s costs and expenses includes the costs attributable to such exempt income. In accordance with paragraph (e)(7)(i), the amount of the qualifying levy for purposes of the formula is the sum of *A'* s liability for the country S income tax and *A'* s liability for the surtax. Accordingly, under the safe harbor formula, *A'* s qualifying amount with respect to the country S income tax and the surtax is 35u ((135u − 25u − 75u)×.50/(1 − .50)). *A'* s specific economic benefit amount is 40u (*A'* s actual payment amount (75u) less *A'* s qualifying amount (35u)).

Example 9. Country T imposes a levy on corporations, called the country T income tax. The country T income tax is imposed at a rate of 50 percent on gross receipts less all costs and expenses, and affiliated corporations are allowed to consolidate their results in applying the country T income tax. Corporations engaged in the exploitation of mineral L in country T are subject to a levy that is identical to the country T income tax except that no consolidation among affiliated corporations is allowed. The levy allows unlimited loss carryforwards.

C and *D* are affiliated U.S. corporations engaged in country T in the exploitation of mineral L. Natural deposits of mineral L in country T are owned by country T, and *C* and *D* have been allowed to extract mineral L in consideration of certain payments to an instrumentality of country T. Therefore, *C* and *D* are dual capacity taxpayers.

The results for *C* and *D* in 1984 and 1985 are as follows:

	1984		1985	
	C	*D*	*C*	*D*
Gross Receipts	120u	0	120u	120u
Costs	20u	50u	20u	20u
Loss Carryforward	....	....	....	50u
Net Income (Loss)	100u	(50u)	100u	50u
Income Tax	50u	....	50u	25u

C and *D* establish that the country T income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1) and is the general tax. *C* and *D* demonstrate that all of the criteria of section 901 are satisfied with respect to the country T income tax as applied to dual capacity taxpayers, except for the determination of the distinct element of such levy that is a tax and of *C* and *D'* s qualifying amounts with respect to that levy. Therefore, the country T income tax as applied to dual capacity taxpayers is a qualifying levy.

In applying the safe harbor formula, in accordance with paragraphs (e)(2)(ii) and (e)(7)(iii), the gross receipts, costs and expenses, and actual payment amounts of *C* and *D* are aggregated, except that in *D'* s loss year (1984) its gross receipts and costs and expenses are disregarded. The results of any loss year are disregarded since the country T income tax as applied to dual capacity taxpayers does not allow consolidation, and, pursuant to paragraph (e)(2)(ii), differences in consolidation provisions between such levy and the country T income tax as applied to persons that are not dual capacity taxpayers are not considered. Accordingly, in 1984 the qualifying amount with respect to the country T income tax is 50u ((120u − 20u − 50u)×.50/(1 − .50)), all of which is considered paid by *C*. In 1985 the qualifying amount is 75u ((120u+120u − 20u − 20u − 50u (loss carry forward)—50u—25u)×.50/(1 − .50)), of which 50u is considered to be paid by *C* and 25u by *D*.

Example 10. Country W imposes a levy called the country W income tax on corporations doing business in country W. The country W income tax is imposed at a 50 percent rate on gross receipts less all costs and expenses. Corporations engaged in the exploitation of mineral M in country W are subject to a levy that is identical in all respects to the country W income tax except that it is imposed at a rate of 80 percent (the ''80 percent levy'').

A is a U.S. corporation engaged in country W in exploitation of mineral M and is subject to the 80 percent levy. Natural deposits of mineral M in country W are owned by country W, and *A* has been allowed to extract mineral M in consideration of certain payments to an instrumentality of country W. Therefore, *A* is a dual capacity taxpayer. *B*, a U.S. corporation affiliated with *A*, also is engaged in business in country W, but has no transactions with country W. *B* is subject to the country W income tax. *B* is a dual capacity taxpayer within the meaning of §1.901–2(a)(2)(ii)(A) by virtue of its affiliation with *A*.

The results for *A* and *B* in 1984 are as follows:

	A	*B*
Gross Receipts	120u	100u
Costs	20u	40u
Net Income	100u	60u
Tax Rate	.80	.50
Tax	80u	30u

A and *B* establish that the country W income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1) and is the general tax. It is assumed that *B* has demonstrated that the country W income tax as applied to *B* does not differ by its terms or in practice from the country W income tax as applied to persons other than dual capacity taxpayers and hence that the country W income tax as applied to *B*, a dual capacity taxpayer, and the country W income tax as applied to such other persons is a single levy. Thus, with respect to *B*, the country W income tax is not a qualifying levy by reason of the last sentence of paragraph (c)(1) of this section. *A* demonstrates that all the criteria of section 901 are satisfied with respect to the 80 percent levy, except for the determination of the distinct element of such levy that is a tax and of *A*'s qualifying amount with respect thereto. Accordingly, the 80 percent levy as applied to *A* is a qualifying levy.

In applying the safe harbor formula in accordance with paragraphs (e)(7)(i) and (e)(7)(iii) in the instant case, it is not necessary to incorporate *B*'s results in the safe harbor formula because *B*'s taxation in country W is identical to the taxation of persons other than dual capacity taxpayers and because neither *A*'s and *B*'s results nor their taxation in country W interact in any way to change *A*'s taxation. All of the amount paid by *B*, 30u, is an amount of income tax paid by *B* within the meaning of §1.901–2(a)(1). Accordingly, under the safe harbor formula, the qualifying amount for *A* with respect to the 80 percent levy is 20u ((120u − 20u − 80u) × .50/(1 − .50)). The remaining 60u paid by *A* (80u − 20u) is *A*'s specific economic benefit amount.

Example 11. The facts are the same as in example 10, except that it is assumed that *B* has not demonstrated that the country W income tax as applied to *B* does not differ by its terms or in practice from the country W income tax as applied to persons other than dual capacity taxpayers. In addition, *A* and *B* demonstrate that all the criteria of section 901 are satisfied with respect to each of the country W income tax and the 80 percent levy as applied to dual capacity taxpayers, except for the determination of the distinct elements of such levies that are taxes of *A* and *B*'s qualifying amounts with respect to such levies. Therefore, the country W income tax and 80 percent levy as applied to dual capacity taxpayers are qualifying levies.

In applying the safe harbor formula in accordance with paragraphs (e)(7)(i) and (e)(7)(iii), the results of *A* and *B* are aggregated. Accordingly, under the safe harbor formula, the aggregate qualifying amount for *A* and *B* with respect to the country W income tax and 80 percent levy is 50u ([(120u + 100u) − (20u + 40u) − (80u + 30u)] × .50/(1 − .50)).

Example 12. Country Y imposes a levy on corporations operating in country Y, called the country Y income tax. Income for purposes of the country Y income tax is computed by subtracting all costs and expenses from a corporation's gross receipts derived from its business in country Y. The rate of the country Y income tax is 50 percent. Country Y also imposes a 20 percent tax (the "withholding tax") on the gross amount of certain income, including dividends, received by persons who are not residents of country Y from persons who are residents of country Y and from corporations that operate there. Corporations engaged in the exploitation of mineral K in country Y are subject to a levy (the "75 percent levy") that is identical in all respects to the country Y income tax except that it is imposed at a rate of 75 percent. Dividends received from such corporations are not subject to the withholding tax.

C, a wholly-owned country Y subsidiary of *D*, a U.S. corporation, is engaged in country Y in the exploitation of mineral K. Natural deposits of mineral K in country Y are owned by country Y, and *C* has been allowed to extract mineral K in consideration of certain payments to an instrumentality of country Y. Therefore, *C* is a dual capacity taxpayer. *D* has elected the safe harbor method for country Y for 1984. In 1984, *C*'s gross receipts are 120u (units of country Y currency), its costs and expenses are 20u, and its liability under the 75 percent levy is 75u. *C* distributes the amount that remains, 25u, as a dividend to *D*.

D establishes that the country Y income tax as applied to persons other than dual capacity taxpayers is an income tax within the meaning of §1.901–2(a)(1) and the general tax, and that all the criteria of section 901 are satisfied with respect to the 75 percent levy, except for the determination of the distinct element of such levy that is tax and of *C*'s qualifying amount with respect thereto. Accordingly, the 75 percent levy is a qualifying levy.

Pursuant to paragraph (e)(7), *D* (which is not subject to a levy of country Y but is considered to receive a specific economic benefit by reason of §1.901–2(a)(2)(ii)(E)) is treated as a dual capacity taxpayer in applying paragraph (e)(7)(ii). *D* demonstrates that the withholding tax is a tax in lieu of an income tax within the meaning of §1.903–1, which tax applies in practice to persons other than dual capacity taxpayers, and that such tax actually would have applied to *D* had *D* not been a dual capacity taxpayer (*i.e.*, had *C* not been a dual capacity taxpayer, in which case *D* also would not have been one). Accordingly, the withholding tax is treated for purposes of the safe harbor formula as if it were an application of the general tax.

In applying the safe harbor formula to this situation in accordance with paragraph (e)(7)(ii), the rates of the country Y income tax and the withholding tax are aggregated into a single effective general tax rate. In this case, the rate is .60 (.50+[(1−.50)×.20]). Accordingly, under the safe harbor formula, *C*'s qualifying amount with respect to the 75 percent levy is 37.5u [(120u−20u−75u) ×.60/(1−.60)], the aggregate amount that *C* and *D* would have paid if *C* had been subject to the country Y income tax and had distributed to *D* as a dividend subject to the withholding tax the entire amount that remained for the year after payment of the country Y income tax. Because *C* is in fact the only taxpayer, the entire qualifying amount is paid by *C*.

Example 13. The facts are the same as in example 12, except that dividends received from corporations engaged in the exploitation of mineral K in country Y are subject to the withholding tax. Thus, *C*'s liability under the 75 percent levy is 75u, and *D*'s liability under the withholding tax on the 25u distribution is 5u.

D, which is a dual capacity taxpayer, demonstrates that the withholding tax as applied to *D* does not differ by its terms or in practice from the withholding tax as applied to persons other than dual capacity taxpayers and hence that the withholding tax as applied to *D* and that levy as applied to such other persons is a single levy. *D* demonstrates that all of the criteria of section 903 are satisfied with respect to the withholding tax. The withholding tax is not a qualifying levy by reason of the last sentence of paragraph (c)(1) of this section.

Paragraphs (e)(7)(i), (e)(7)(ii) and (e)(7)(iii) all apply in this situation. As in example 10, it is not necessary to incorporate the withholding tax into the safe harbor formula. All of the amount paid by *D*, 5u, is an amount of tax paid by *D* in lieu of an income tax. In applying the safe harbor formula to *C*, therefore, with respect to the 75 percent levy, ''A'' is 120, ''B'' is ''20'', ''C'' is 75 and ''D'' is .50. Accordingly, *C*'s qualifying amount with respect to the 75 percent levy is 25u; the remaining 50u that it paid is its specific economic benefit amount.

Example 14. The facts are the same as in example 12, except that dividends received from corporations engaged in the exploitation of mineral K in country Y are subject to a 10 percent withholding tax (the ''10 percent withholding tax''). Thus, *C*'s liability under the 75 percent levy is 75u, and *D*'s liability under the 10 percent withholding tax on the 25u distribution is 2.5u.

The only difference between the withholding tax and the 10 percent withholding tax applicable only to dual capacity taxpayers (including *D*) is that a lower rate (but the same base) applies to dual capacity taxpayers. Although the withholding tax and the 10 percent withholding tax are together a single levy, this difference makes it necessary, when dealing with multiple levies, to incorporate the withholding tax and *D*'s payment pursuant to the 10 percent withholding tax in the safe harbor formula. Accordingly, as in example 12, the safe harbor formula is applied by aggregation.

The aggregate effective rate of the general taxes for purposes of the safe harbor formula is .60 (.50+[(1−.50)×.20]). Pursuant to paragraph (e)(7), the aggregate actual payment amount of the qualifying levies for purposes of the formula is the sum of *C* and *D*'s liability for the 75 percent levy and the 10 percent withholding tax. Accordingly, under the safe harbor formula, the aggregate qualifying amount with respect to the 75 percent levy on *C* and the 10 percent withholding tax on *D* is 33.75u ((120u−20u−[75u+2.5u])×.60/(1−.60)), which is the aggregate amount of tax that *C* and *D* would have paid if *C* had been subject to the country Y income tax and had paid out its entire amount remaining after payment of that tax to *D* as a dividend subject to the withholding tax.

Example 15. The facts are the same as in example 5, except that the rate of the country E income tax is 45 percent and a political subdivision of country E also imposes a levy, called the ''local tax,'' on all corporations subject to the country E income tax. The base of the local tax is the same as the base of the country E income tax; the rate is 10 percent.

The reasoning of example 5 with regard to the country E income tax as applied to *A* and *B*, respectively, applies equally with regard to the local tax as applied to *A* and *B*, respectively. Accordingly, the entire amount paid by *A* pursuant to each of the country E income tax and the local tax is an amount of income tax paid, and both the country E income tax as applied to *B* and the local tax as applied to *B* are qualifying levies.

Pursuant to paragraph (e)(7), in applying the safe harbor formula to *B*, ''A'' is the amount of *B*'s gross receipts as determined under the (identical) country E income tax and local tax as applied to *B*; ''B'' is the amount of *B*'s costs and expenses thereunder; and ''C'' is the sum of *B*'s actual payment amounts with respect to the two levies. Pursuant to paragraph (e)(7), in applying the safe harbor formula to *B*, *B*'s aggregate qualifying amount with respect to the two levies is limited to the amount determined in accordance with paragraph (e)(5) where ''D'' is the rate of tax specified in section 11(b)(5) of the Internal Revenue Code. Accordingly, ''D'' is .46, which is the lower of the aggregate rate (55 percent) of the qualifying levies or the section 11(b)(5) rate (46 percent). *B*'s aggregate qualifying amount is, therefore, identical to *B*'s qualifying amount in example 6, which is less than its aggregate actual payment amount, and the difference is *B*'s specific economic benefit amount.

(f) *Effective date.* The effective date of this section is as provided in §1.901–2(h).

(Approved by the Office of Management and Budget under control number 1545–0746)

[T.D. 7918, 48 FR 46284, Oct. 12, 1983]

§ 1.901–3 Reduction in amount of foreign taxes on foreign mineral income allowed as a credit.

(a) *Determination of amount of reduction*—(1) *In general.* For purposes of determining the amount of taxes which are allowed as a credit under section 901(a) for taxable years beginning after December 31, 1969, the amount of any income, war profits, and excess profits taxes paid or accrued, or deemed to be paid under section 902, during the taxable year to any foreign country or possession of the United States with respect to foreign mineral income (as defined in paragraph (b) of this section) from sources within such country or possession shall be reduced by the amount, if any, by which—

(i) The smaller of—

(a) The amount of such foreign income, war profits, and excess profits taxes, or

(b) The amount of the tax which would be computed under chapter 1 of the Code for such year with respect to such foreign mineral income if the deduction for depletion were determined under section 611 without regard to the deduction for percentage depletion under section 613, exceeds

(ii) The amount of the tax computed under chapter 1 of the Code for such year with respect to such foreign mineral income.

The reduction required by this subparagraph must be made on a country-by-country basis whether the taxpayer uses for the taxable year the per-country limitation under section 904(a)(1), or the overall limitation under section 904(a)(2), on the amount of taxes allowed as credit under section 901(a).

(2) *Determination of amount of tax on foreign mineral income*—(i) *Foreign tax.* For purposes of subparagraph (1)(i)*(a)* of this paragraph, the amount of the income, war profits, and excess profits taxes paid or accrued during the taxable year to a foreign country or possession of the United States with respect to foreign mineral income from sources within such country or possession is an amount which is the greater of—

(a) The amount by which the total amount of the income, war profits, and excess profits taxes paid or accrued during the taxable year to such country or possession exceeds the amount of such taxes that would be paid or accrued for such year to such country or possesion without taking into account such foreign mineral income, or

(b) The amount of the income, war profits, and excess profits taxes that would be paid or accrued to such country or possession if such foreign mineral income were the taxpayer's only income for the taxable year, except that in no case shall the amount so determined exceed the total of all income, war profits, and excess profits taxes paid or accrued during the taxable year to such country or possession. For such purposes taxes which are paid or accrued also include taxes which are deemed paid under section 902. In the case of a dividend described in paragraph (b)(2)(i) *(a)* of this section which is from sources within a foreign country or possession of the United States and is attributable in whole or in part to foreign mineral income, the amount of the income, war profits, and excess profits taxes deemed paid under section 902 during the taxable year to such country or possession with respect to foreign mineral income from sources within such country or possession is an amount which bears the same ratio to the amount of the income, war profits, and excess profits taxes deemed paid under section 902 during such year to such country or possession with respect to such dividend as the portion of the dividend which is attributable to foreign mineral income bears to the total dividend. For purposes of *(a)* and *(b)* of this subdivision, foreign mineral income is to be reduced by any credits, expenses, losses, and other deductions which are properly allocable to such income under the law of the foreign country or possession of the United States from which such income is derived.

(ii) *U.S. tax.* For purposes of subparagraph (1)(ii) of this paragraph, the amount of the tax computed under