

operations for the taxable year 1980 with respect to the 40-percent stock interest acquired by N is \$4,000.

[T.D. 7894, 48 FR 22539, May 19, 1983]

§ 1.956-1 Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property.

(a) *In general.* Section 956(a)(1) and paragraph (b) of this section provide rules for determining the amount of a controlled foreign corporation's earnings invested in United States property at the close of any taxable year. Such amount is the aggregate amount invested in United States property to the extent such amount would have constituted a dividend if it had been distributed on such date. Subject to the provisions of section 951(a)(4) and the regulations thereunder, a United States shareholder of a controlled foreign corporation is required to include in his gross income his pro rata share, as determined in accordance with paragraph (c) of this section, of the controlled foreign corporation's increase for any taxable year in earnings invested in United States property but only to the extent such share is not excludable from his gross income under the provisions of section 959(a)(2) and the regulations thereunder.

(b) *Amount of a controlled foreign corporation's investment of earnings in United States property—(1) Dividend limitation.* The amount of a controlled foreign corporation's earnings invested at the close of its taxable year in United States property is the aggregate amount of such property held, directly or indirectly, by such corporation at the close of its taxable year to the extent such amount would have constituted a dividend under section 316 and §§ 1.316-1 and 1.316-2 (determined after the application of section 955(a)) if it had been distributed on such closing day. For purposes of this subparagraph, the determination of whether an amount would have constituted a dividend if distributed shall be made without regard to the provisions of section 959(d) and the regulations thereunder.

(2) *Aggregate amount of United States property.* For purposes of determining an increase in earnings invested in United States property for any taxable

year beginning after December 31, 1975, the aggregate amount of United States property held by a controlled foreign corporation at the close of—

(i) Any taxable year beginning after December 31, 1975, and

(ii) The last taxable year beginning before January 1, 1976 does not include stock or obligations of a domestic corporation described in section 956(b)(2)(F) or movable property described in section 956(b)(2)(G).

(3) *Treatment of earnings and profits.* For purposes of making the determination under subparagraph (1) of this paragraph as to whether an amount of investment would have constituted a dividend if distributed at the close of any taxable year of a controlled foreign corporation, earnings and profits of the controlled foreign corporation shall be considered not to include any amounts which are attributable to—

(i) Amounts which have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 951(a)(1)(B) (or which would have been so included but for section 959(a)(2)) and have not been distributed, or

(ii)(a) Amounts which are included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) or would be so included under such section but for the fact that such amounts were distributed to such shareholder during the taxable year, or

(b) Amounts which, for any prior taxable year, have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) and have not been distributed.

The rules of this subparagraph apply only in determining the limitation on a controlled foreign corporation's increase in earnings invested in United States property. See section 959 and the regulations thereunder for limitations on the exclusion from gross income of previously taxed earnings and profits.

(4) [Reserved]

(c) *Shareholder's pro rata share of increase—(1) General rule.* A United States shareholder's pro rata share of a controlled foreign corporation's increase

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for any taxable year in earnings invested in United States property is the amount determined by subtracting the shareholder's pro rata share of—

(i) The controlled foreign corporation's earnings invested in United States property at the close of its preceding taxable year, as determined under paragraph (b) of this section, reduced by amounts paid by such corporation during such preceding taxable year to which section 959(c)(1) and the regulations thereunder apply, from his pro rata share of

(ii) The controlled foreign corporation's earnings invested in United States property at the close of its current taxable year, as determined under paragraph (b) of this section.

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

Example 1. A is a United States shareholder and direct owner of 60 percent of the only class of stock of R Corporation, a controlled foreign corporation during the entire period here involved. Both A and R Corporation use the calendar year as a taxable year. Corporation R's aggregate investment in United States property on December 31, 1964, which would constitute a dividend (as determined under paragraph (b) of this section) if distributed on such date is \$150,000. During the taxable year 1964, R Corporation distributed \$50,000 to which section 959(c)(1) applies. Corporation R's aggregate investment in United States property on December 31, 1965, is \$250,000; and R Corporation's current and accumulated earnings and profits on such date (determined as provided in paragraph (b) of this section) are \$225,000. A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property is \$75,000, determined as follows:

(i) Aggregate investment in United States property on December 31, 1965	\$250,000	
(ii) Current and accumulated earnings and profits on December 31, 1965	225,000	
(iii) Amount of earnings invested in United States property on December 31, 1965, which would constitute a dividend if distributed on such date (lesser of item (i) or item (ii))	225,000	
(iv) Aggregate investment in United States property on December 31, 1964, which would constitute a dividend if distributed on such date	\$150,000	
Less: Amounts distributed during 1964 to which section 959(c)(1) applies	50,000	100,000
(v) R Corporation's increase for 1965 in earnings invested in United States property (item (iii) minus item (iv))		125,000

(vi) A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property (item (v) times 60 percent)	75,000
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Example 2. The facts are the same as in example 1, except that R Corporation's current and accumulated earnings and profits on December 31, 1965, are \$100,000 instead of \$225,000. Accordingly, even through R Corporation's aggregate investment in United States property on December 31, 1965, of \$250,000 exceeds the net amount (\$100,000) taken into account under subparagraph (1)(i) of this paragraph as of December 31, 1964, by \$150,000, there is no increase for taxable year 1965 in earnings invested in United States property because of the dividend limitation of paragraph (b)(1) of this section. Corporation R's aggregate investment in United States property on December 31, 1966, is unchanged (\$250,000) Corporation R's current and accumulated earnings and profits on December 31, 1966, are \$175,000, and, as a consequence, its aggregate investment in United States property which would constitute a dividend if distributed on that date is \$175,000. Corporation R pays no amount during 1965 to which section 959(c)(1) applies. Corporation R's increase for the taxable year 1966 in earnings invested in United States property is \$75,000, and A's pro rata share of that amount is \$45,000 (\$75,000 times 60 percent).

(d) *Date and basis of determinations.* The determinations made under paragraph (c)(1)(i) of this section with respect to the close of the preceding taxable year of a controlled foreign corporation and under paragraph (c)(1)(ii) with respect to the close of the current taxable year of such controlled foreign corporation, for purposes of determining the United States shareholder's pro rata share of such corporation's increased investment of earnings in United States property for the current taxable year, shall be made as of the last day of the current taxable year of such corporation but on the basis of stock owned, within the meaning of section 958(a) and the regulations thereunder, by such United States shareholder on the last day of the current taxable year of the foreign corporation on which such corporation is a controlled foreign corporation. See the last sentence of section 956(a)(2). The application of this paragraph may be illustrated from the following example:

Example. Domestic corporation M owns 60 percent of the only class of stock of A Corporation, a controlled foreign corporation

during the entire period here involved. Both M Corporation and A Corporation use the calendar year as a taxable year. Corporation A's investment of earnings in United States property at the close of the taxable year 1963 is \$100,000, as determined under paragraph (b) of this section, and M Corporation includes its pro rata share of such amount (\$60,000) in gross income for its taxable year 1963. On June 1, 1964, M Corporation acquires an additional 25 percent of A Corporation's outstanding stock from a person who is not a United States person as defined in section 957(d). Corporation A's investment of earnings in United States property at the close of the taxable year 1964, as determined under paragraph (b) of this section, is unchanged (\$100,000). Corporation A pays no amount during 1963 to which section 959(c)(1) applies. Corporation M is not required, by reason of the acquisition in 1964 of A Corporation's stock, to include an additional amount in its gross income with respect to A Corporation's investment of earnings in United States property even though the earnings invested in United States property by A Corporation attributable to the stock acquired by M Corporation were not previously taxed. The determination made under paragraph (c)(1)(i) of this section as well as the determination made under paragraph (c)(1)(ii) of this section with respect to A Corporation's investment for 1964 of earnings in United States property are made on the basis of stock owned by M Corporation (85 percent) at the close of 1964.

(e) *Amount attributable to property*—(1) *General rule.* Except as provided in subparagraph (2) of this paragraph, for purposes of paragraph (b)(1) of this section the amount taken into account with respect to any United States property shall be its adjusted basis, as of the applicable determination date, reduced by any liability (other than a liability described in subparagraph (3) of this paragraph) to which such property is subject on such date. To be taken into account under this subparagraph, a liability must constitute a specific charge against the property involved. Thus, a liability evidenced by an open account or a liability secured only by the general credit of the controlled foreign corporation will not be taken into account. On the other hand, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item

on the applicable determination date bears to the adjusted basis of all such items at such time. A liability in excess of the adjusted basis of the property which is subject to such liability shall not be taken into account for the purpose of reducing the adjusted basis of other property which is not subject to such liability.

(2) *Rule for pledges and guarantees.* For purposes of this section the amount taken into account with respect to any pledge or guarantee described in paragraph (c)(1) of § 1.956-2 shall be the unpaid principal amount on the applicable determination date of the obligation with respect to which the controlled foreign corporation is a pledgor or guarantor.

(3) *Excluded charges.* For purposes of subparagraph (1) of this paragraph, a specific charge created with respect to any item of property principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation's investment of earnings in United States property will not be recognized; whether a specific charge is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to a loan is whether the loan is from a related person, as defined in section 954 (d)(3) and paragraph (e) of § 1.954-1.

(4) *Statement required.* If for purposes of this section a United States shareholder of a controlled foreign corporation reduces the adjusted basis of property which constitutes United States property on the ground that such property is subject to a liability, he shall attach to his return a statement setting forth the adjusted basis of the property before the reduction and the amount and nature of the reduction.

(Secs. 956(c), 7805, Internal Revenue Code of 1954 (76 Stat. 1017, 68A Stat. 917; (26 U.S.C. 956(c) and 7805 respectively)))

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