

of its United States shareholders, makes returns on a calendar year basis, while B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, A must return his assumed dividend as income for the taxable year 1954 and B must return his distributive share as income for the fiscal year ending November 30, 1955. In applying this rule, the date as of which the United States group last existed with respect to the company is immaterial. Thus, in the foregoing example, if September 30, 1954, was the last day on which the United States group with respect to the M Corporation existed, B would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1955, even though September 30, 1954, the date as of which the distribution is assumed to have been made, does not fall within such fiscal year.

(e) For the treatment of gain on the sale of certain stock, see section 306(f) and paragraph (h) of § 1.306-3.

§ 1.551-3 Deduction for obligations of the United States and its instrumentalities.

(a) Each United States shareholder required to return his distributive share of undistributed foreign personal holding company income for any taxable year shall take into account in computing the credit against tax under section 35, or the deduction under section 242, whichever is allowable to such shareholder, his proportionate share of whatever interest on obligations of the United States or its instrumentalities (as specified in sections 35 or 242, as the case may be) may be included in the gross income of the company for such taxable year, with the exception of any such interest as may be so included by reason of the application of the provisions of section 555. For reduction of credit for such interest on account of amortizable bond premium, see section 171 and the regulations thereunder.

(b) The rule set forth in paragraph (a) of this section may be illustrated by the following example:

Example. The M Corporation is a foreign personal holding company which owns all the stock of the N Corporation, another foreign personal holding company. Both compa-

nies receive interest on obligations of the United States or its instrumentalities as specified in section 35. In determining the amount of the credit allowable under section 35 (if the shareholder is an individual) or the deduction allowable under section 242 (if the shareholder is a corporation), the United States shareholder of the M Corporation would be entitled to a credit or a deduction, as the case may be, only for his proportionate share of the interest received by that Company and not for any part of the interest received by the N Corporation, regardless of whether the interest received by the N Corporation is included in the gross income of the M Corporation as an actual dividend or as a constructive dividend under section 555.

§ 1.551-4 Information in return.

The information required by section 551(d) in the returns of certain United States shareholders relates only to the taxable year of a foreign personal holding company for which any part of such corporation's undistributed foreign personal holding company income must be included in gross income by the United States shareholder of whom the information is required. The information shall be submitted as a part of the income tax return in the form of a statement attached to the return.

§ 1.551-5 Effect on capital account of foreign personal holding company and basis of stock in hands of shareholders.

(a) Sections 551(e) and 551(f) are designed to prevent double taxation with respect to the undistributed foreign personal holding company income.

(b) The application of sections 551(e) and 551(f) may be illustrated by the following examples:

Example 1. The M Corporation is a foreign personal holding company. Seventy-five percent in value of its capital stock is owned by A, a citizen of the United States, and the remainder, or 25 percent, of its stock is owned by B, a nonresident alien individual. For the calendar year 1954 the M Corporation has an undistributed foreign personal holding company income of \$100,000. A is required to include \$75,000 of such income in gross income as a dividend in his return for the calendar year 1954. The \$100,000 is treated as paid-in surplus or as a contribution to the capital of the M Corporation and its accumulated earnings and profits as of the close of the calendar year 1954 are correspondingly reduced. If after treating such \$100,000 as paid-in surplus or as a contribution to capital, the M Corporation has no accumulated earnings and

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profits at the close of 1954, and if for the calendar year 1955, the M Corporation had no earnings and profits, but distributed \$40,000, the amount so distributed would be a nontaxable distribution and would not be included in the gross income of either A or B for the calendar year 1955. If, however, after treating the \$100,000 as paid-in surplus or as a contribution to capital, the M Corporation had accumulated earnings and profits of \$100,000 at the close of 1954, the facts otherwise being the same, the distributions in 1955 would be taxable to A as a dividend, and the taxability of such distributions to B would depend upon the application of section 861(a)(2), relating to the treatment of dividends from a foreign corporation as income from sources within or without the United States.

Example 2. In example 1 assume the basis of A's stock to be \$300,000. If A includes in gross income in his return for the calendar year 1954, \$75,000 as a dividend from the M Corporation, the basis of his stock would be \$375,000. After the nontaxable distribution of \$30,000 to A by the M Corporation in 1955 (75 percent of the \$40,000 distribution) the basis of A's stock, assuming no other changes, would be \$345,000. If A failed to include the \$75,000 as a dividend in gross income in his return for 1954 and his failure was not discovered until after the 6-year period of limitations had expired, the application of the rule would not increase the basis of A's stock. The subsequent nontaxable distribution of \$30,000 to A in 1955 would reduce his basis of \$300,000 to \$270,000, thus tending to compensate for his failure to include the amount of \$75,000 as a dividend in his gross income for 1954. If the undistributed foreign personal holding company income of the M Corporation is readjusted within the statutory period of limitations, thus increasing or decreasing the amount A would have to include in his gross income, proper adjustment is required to be made to the basis of A's stock on account of such readjustment.

§ 1.552-1 Definition of foreign personal holding company.

(a) A foreign personal holding company is any foreign corporation, other than a corporation exempt from taxation under subchapter F (section 501 and following), chapter 1 of the Code, and other than certain banking institutions which satisfy the requirements of section 552(b)(2) and paragraph (b) of § 1.552-4 which for the taxable year meets (1) the gross income requirement specified in section 552(a)(1); and (2) the stock ownership requirement specified in section 552(a)(2). Both requirements

must be satisfied with respect to each taxable year.

(b) A foreign corporation which comes within the classification of a foreign personal holding company is not subject to taxation either under section 531 or section 541. See sections 532(b)(2) and 542(c)(5). The fact that a foreign corporation is a foreign personal holding company does not relieve the corporation from liability for the taxes imposed generally upon foreign corporations, such as the taxes imposed by sections 881 and 882, since such taxes apply regardless of the classification of the foreign corporation as a foreign personal holding company.

§ 1.552-2 Gross income requirement.

(a) To meet the gross income requirement, it is necessary that either of the following percentages of gross income of the corporation for the taxable year (including the additions to gross income provided in section 555(b) as required by section 555(c)(2)) be foreign personal holding company income as defined in section 553:

(1) 60 percent or more; or

(2) 50 percent or more if the foreign corporation has been classified as a foreign personal holding company for any taxable year ending after August 26, 1937, unless:

(i) A taxable year has intervened since the last taxable year for which it was so classified, during no part of which the stock ownership requirement specified in section 552(a)(2) exists; or

(ii) Three consecutive years have intervened since the last taxable year for which it was so classified, during each of which its foreign personal holding company income was less than 50 percent of its gross income.

(b) In determining whether the foreign personal holding company income is equal to the required percentage of the total gross income, the determination must not be made upon the basis of gross receipts, since gross income is not synonymous with gross receipts. For meaning of gross income in this part, see section 555 and § 1.555-1.

§ 1.552-3 Stock ownership requirement.

(a) To meet the stock ownership requirement, it is necessary that at some