

property in respect of which such overriding royalties are paid, and to mineral, oil, or gas production payments, only with respect to amounts received after September 30, 1958.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6739, 29 FR 7715, June 17, 1964]

§ 1.554-1 Stock ownership.

For regulations under section 554, see § 1.552-3.

§ 1.555-1 General rule.

The gross income of a foreign corporation which is a foreign personal holding company is computed the same as if the foreign corporation were a domestic corporation which is a personal holding company. See section 542(a)(1) and § 1.542-2. The gross income of a foreign personal holding company thus includes income from all sources, whether within or without the United States, which is not specifically excluded from gross income under any other provisions of the Code. For example, the gross income of a foreign personal holding company includes all income from sources outside the United States even though the foreign personal holding company is a foreign corporation not engaged in trade or business within the United States. However, the gross income of a foreign corporation which is a foreign personal holding company shall not include, with respect to a United States shareholder described in section 951(b), dividends received by such corporation which are excluded under section 959(b) from the income of such corporation with respect to such shareholder.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6795, 30 FR 934, Jan. 29, 1965]

§ 1.555-2 Additions to gross income.

(a) If, for any taxable year:

(1) A foreign corporation meets the stock ownership requirement specified in section 552(a)(2) and § 1.552-3, regardless of whatever day in its taxable year is the last day on which the required United States group exists, and

(2) Such foreign corporation is a shareholder in a foreign personal holding company on any day of a taxable year of the second company which ends

with or within the taxable year of the first company and such day is the last day in the taxable year of the second company in which the United States group exists with respect to the second company, then for the purpose of:

(i) Determining whether the first company meets the specified gross income requirement so as to come within the classification of a foreign personal holding company, and

(ii) Determining the undistributed foreign personal holding company income of the first company which (in the event the first company is a foreign personal holding company) is to be included, in whole or in part, in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies,

there shall be included as a dividend in the gross income of the first company for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend, if on the last day referred to in this subparagraph there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year. The foregoing rules apply to any chain of foreign corporations regardless of the number of corporations included in the chain.

(b) The application of section 555(b) may be illustrated by the following examples:

Example 1. The X Corporation is a foreign corporation whose stock is owned by A, a United States citizen. The X Corporation owns the entire stock of the Y Corporation, another foreign corporation. The taxable year of the X Corporation is the calendar year and the taxable year of the Y Corporation is the fiscal year ending June 30. For the fiscal year ending June 30, 1955, more than the required percentage of the Y Corporation's gross income consists of foreign personal holding company income and no part of the earnings for such year is distributed as dividends. On the basis of these facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1955. The X Corporation meets the stock

ownership requirement and constitutes a foreign personal holding company for 1955, if it also meets the gross income requirement. For the purpose of determining whether the X Corporation meets the gross income requirements, the entire undistributed foreign personal holding company income of the Y Corporation for the fiscal year ending June 30, 1955, must be included as a dividend in the gross income of the X Corporation for 1955, since:

(1) The X Corporation was a shareholder in the Y Corporation on a day (June 30, 1955) in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation, which day was the last day in the taxable year of the Y Corporation on which the United States group required with respect to the Y Corporation existed,

(2) Such last day was also the end of the Y Corporation's taxable year so that the portion of the taxable year of the Y Corporation up to and including such last day is equal to 100 percent of the taxable year of the Y Corporation, and, therefore, the portion of the undistributed foreign personal holding company income of the Y Corporation includible in the gross income of its shareholders is likewise equal to 100 percent, and

(3) The X Corporation being the sole shareholder of the Y Corporation must include such portion in its gross income for 1955, the taxable year in which or with which the taxable year of the Y Corporation ends. If, after the inclusion of the presumptive dividend in its gross income, the X Corporation is a foreign personal holding company for 1955, then the undistributed foreign personal holding company income of the Y Corporation must also be included as a dividend in the gross income of the X Corporation in determining its undistributed foreign personal holding company income which is to be included in the gross income of A, the sole shareholder in the X Corporation. On the other hand, if, after including such presumptive dividend, the X Corporation does not constitute a foreign personal holding company, the undistributed foreign personal holding company income of the Y Corporation is not includible in the gross income of the X Corporation.

Example 2. The X Corporation referred to in example 1 sold the stock in the Y Corporation to other interests on September 30, 1955, so that after that date no United States group existed with respect to the Y Corporation. For the fiscal year ending June 30, 1956, more than the required percentage of the gross income of the Y Corporation consists of foreign personal holding company income. The taxable income of the Y Corporation for such fiscal year amounts to \$1,000,000, of which \$900,000 is distributed in dividends after September 30, 1955. The undistributed foreign personal holding company income of the Y Corporation for such fiscal year amounts to \$100,000. Upon the basis of these

facts the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1956, since at one time in such fiscal year, or from July 1 to and including September 30, 1955, it meets the stock ownership requirement, and the gross income requirement is also satisfied. In determining whether the X Corporation constitutes a foreign personal holding company for 1956, a portion of the undistributed foreign personal holding company income of the Y Corporation for the fiscal year ending June 30, 1956 (three-twelfths of \$100,000, or \$25,000), must be included as a dividend in the gross income of the X Corporation, since:

(1) The X Corporation was a shareholder in the Y Corporation on September 30, 1955, or on a day in the taxable year of the Y Corporation ending with or within the taxable year of the X Corporation which day was the last day in the Y Corporation's taxable year on which the United States group required with respect to the Y Corporation existed.

(2) The portion of the taxable year of the Y Corporation up to and including such day is three-twelfths of the entire taxable year of the Y Corporation and, therefore, the portion of the undistributed foreign personal holding company income of the Y Corporation includible in the gross income of its shareholders also is equal to three-twelfths, and

(3) The X Corporation, being the sole shareholder of the Y Corporation at the time the United States group with respect to the Y Corporation last existed, must include all of such portion in its gross income for 1956, the taxable year of the X Corporation in which or with which the taxable year of the Y Corporation ends.

It is to be observed that three-twelfths of the undistributed foreign personal holding company income of the Y Corporation for the entire taxable year and not the earnings realized by the Y Corporation up to and including September 30, 1955, the last day on which the United States group with respect to the Y Corporation existed, must be included in the gross income of the X Corporation.

Example 3. The X Corporation referred to in example 1 sold the stock in the Y Corporation to other interests on September 30, 1955, so that after that date a different United States group existed with respect to the Y Corporation. Assuming that the Y Corporation is a foreign personal holding company for the fiscal year ending June 30, 1956, no part of the undistributed foreign personal holding company income of the Y Corporation for such fiscal year would, in this instance, be includible in the gross income of the X Corporation for the year 1956, in determining whether the X Corporation is a foreign personal holding company for that year. In such case, the undistributed foreign personal holding company income of the Y Corporation is includible in the gross income of

the other foreign personal holding companies, if any, and of the United States shareholders who are shareholders in the Y Corporation the day after September 30, 1955, which was the last day in the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation existed. If, however, the X Corporation sells 90 percent of its stock in the Y Corporation and thus is a minority shareholder in the Y Corporation on the last day of the taxable year of the Y Corporation on which the United States group with respect to the Y Corporation exists, the portion of the undistributed foreign personal holding company income allocable to the minority interests of the X Corporation would be includible in the gross income of the X Corporation, even though on such last day the United States group is not the same with respect to both corporations.

Example 4. If the Y Corporation in example 1 owns all of the stock of the Z Corporation, another foreign corporation, there would be a chain of three foreign corporations. In such case, assuming that the Z Corporation is a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation for the purpose of determining whether the Y Corporation comes within the classification of a foreign personal holding company. If, after the inclusion of such presumptive dividend, the Y Corporation is a foreign personal holding company, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation in determining the undistributed foreign personal holding company income of the Y Corporation which is includible in the gross income of its shareholder, the X Corporation. The same process would be repeated with respect to determining whether the X Corporation is a foreign personal holding company and in determining its undistributed foreign personal holding company income. If all three corporations are foreign personal holding companies, the undistributed foreign personal holding company income of each would, in this manner, be reflected as a dividend in the gross income of A, the ultimate beneficial shareholder of the chain. In the event that after the inclusion of the undistributed foreign personal holding company income of the Z Corporation in the gross income of the Y Corporation, the Y Corporation is not a foreign personal holding company, then no part of the income of either the Z Corporation or the Y Corporation would be includible in the gross income of the X Corporation. In that event, whether the X Corporation is a foreign personal holding company, and its undistributed foreign personal holding com-

pany income, would be determined independently of the income of the Y Corporation and the Z Corporation.

§ 1.556-1 Definition.

Undistributed foreign personal holding company income is the amount which is to be included in the gross income of the United States shareholders under section 551(b) and § 1.551-2. Undistributed foreign personal holding company income is the taxable income of the foreign personal holding company, as defined in section 63(a) (computed without regard to subchapter N, chapter 1 of the Code), and adjusted in the manner described in section 556(b) and § 1.556-2, less the deduction for dividends paid (§§ 1.561-1 through 1.565-6). See § 1.556-3 for an illustration of the computation of undistributed foreign personal holding company income.

§ 1.556-2 Adjustments to taxable income.

(a) *Taxes*—(1) *General rule.* (i) In computing undistributed foreign personal holding company income for any taxable year, there shall be allowed as a deduction the Federal income and excess profits taxes accrued during the taxable year except that no deduction shall be allowed for (a) the accumulated earnings tax imposed by section 531 (or a corresponding section of a prior law), (b) the personal holding company tax imposed by section 541 (or a corresponding section of a prior law), and (c) the excess profits tax imposed by subchapter E, chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940. The deduction is for taxes for the taxable year determined under the accrual method of accounting, regardless of whether the corporation uses an accrual method of accounting, the cash receipts and disbursements method, or any other allowable method of accounting. In computing the amount of taxes accrued, an unpaid tax which is being contested is not considered accrued until the contest is resolved.

(ii) However, the corporation shall deduct taxes paid, rather than taxes accrued, if it used that method with respect to Federal taxes for each taxable year for which it was subject to the provisions of supplement P, subchapter