

does not include in income his pro rata amount of the undistributed portion of excess capital gains, he is not a qualified shareholder for 1966 (or for any subsequent year). In such a case, the \$8 is not treated under the provisions of section 1247(d)(1) as a distribution of long-term capital gains for such year but as a corporate distribution taxable as ordinary income to the extent provided in subchapter C, chapter 1 of the Code.

(c) *Adjustments relating to undistributed capital gains—(1) Adjustments in earnings and profits of the company.* If a foreign investment company, to which the election under section 1247(a) applies, designates an amount as the undistributed portion of excess capital gains for its taxable year, the earnings and profits of the company (within the meaning of subchapter C, chapter 1 of the Code) shall be reduced, and its capital account shall be increased, by such amount.

(2) *Increase in basis of qualified shareholder's stock.* A qualified shareholder, who computes his long-term capital gains for a taxable year by including (in respect of each share of stock which he owns in a foreign investment company) the pro rata amount of the undistributed portion of the excess capital gains which was designated by the company for its taxable year ending with or within such taxable year of the shareholder, shall, as of the day following the close of such taxable year of the company, increase the adjusted basis of each share by such pro rata amount.

(d) *Loss on sale or exchange of certain stock held 1 year or less—(1) In general.* If:

(i) A qualified shareholder of a foreign investment company to which the election under section 1247(a) applies treats any amount designated under section 1247(a)(1)(B) with respect to a share of stock as long-term capital gain, and

(ii) Such share is held by the taxpayer for 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less,

Then any loss on the sale or exchange of such share shall, to the extent of the amount described in subdivision (i) of this subparagraph, be treated under section 1247(i) as loss from the sale or exchange of a capital asset held for

more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

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

Example: On October 1, 1966, B, a calendar year taxpayer, purchases for \$100 a share of stock in a foreign investment company to which the election under section 1247(a) applies. On January 20, 1967, the company, in a notice to B, designates for its taxable year ending December 31, 1966, \$8 per share as excess capital gains of which \$6 was distributed on December 1, 1966, and \$2 was designated as undistributed. B includes the \$8 in computing his long-term capital gains in his return for 1966 and, under paragraph (c)(2) of this section, B's basis for the share is increased to \$102 as of January 1, 1967. On February 1, 1967, B sells the share for \$93, incurring a \$9 loss of which \$8 is treated as a long-term capital loss under section 1247(i) and \$1 is treated as a short-term capital loss.

[T.D. 6798, 30 FR 1175, Feb. 4, 1965, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1247-4 Election by foreign investment company with respect to foreign tax credit.

(a) *In general—(1) Election.* If an election to distribute income currently pursuant to section 1247(a) is in effect for a taxable year of a foreign investment company, and if at the close of such taxable year more than 50 percent of the value of the total assets of the company consists of stock or securities in foreign corporations, then the company may elect for such taxable year, in the manner provided in paragraph (d) of this section, the application of section 1247(f) in respect of foreign taxes referred to in subparagraph (2) of this paragraph which are paid during such taxable year. For purposes of this section, the term *value* shall have the same meaning as assigned to such term in section 851(c)(4) (relating to definition of regulated investment company). For definition of foreign corporation, see section 7701(a).

(2) *Taxes affected.* The election under section 1247(f) for a taxable year applies with respect to income, war profits, and excess profits taxes described in section 901(b)(1) which are paid by the company to foreign countries and possessions of the United States. A tax paid by a foreign investment company does not include a tax which is paid by

the shareholders of the company. Whether a tax is paid by the company, and whether a tax is an income, war profits, or excess profits tax described in section 901(b)(1), shall be determined under the principles of chapter 1 of the Code without regard to the law of any foreign country and without regard to any income tax convention, including any income tax convention to which the United States is a party. Section 1247(f) does not apply with respect to foreign taxes which would be deemed to have been paid by the company under section 902 if the company were a domestic corporation. For purposes of this paragraph, taxes paid to the United States are not considered foreign taxes.

(b) *Effect of election*—(1) *Effect on company*. If a valid election under section 1247(f) is made for a taxable year of a foreign investment company, then, for purposes of determining under section 1247(a)(1)(A) whether the company has distributed to its shareholders with respect to such taxable year 90 percent or more of what the company's taxable income would be for such year if the company were a domestic corporation, the following rules shall apply:

(i) The company shall compute such taxable income without any deduction for the foreign taxes referred to in paragraph (a)(2) of this section which were paid or accrued during the taxable year.

(ii) If the amount of taxable income (computed without regard to subdivision (i) of this subparagraph) is more than zero, the company shall treat the foreign taxes referred to in paragraph (a)(2) of this section which were paid during such taxable year of the company as distributed to its shareholders to the extent of the amount which bears the same ratio to the amount of such foreign taxes as (a) the amount actually distributed (or treated as distributed pursuant to an election under section 1247(a)(2)(B)) during such taxable year from such taxable income (determined without regard to subdivision (i) of this subparagraph), bears to (b) the amount of such taxable income (also determined without regard to such subdivision (i)). Thus, for example, if for a taxable year a foreign investment company has taxable income

of \$1,000 (determined after deducting foreign taxes paid of \$100), and if \$600 of such taxable income is distributed during the taxable year and \$350 of such taxable income is distributed not later than 2 months and 15 days after the close of the taxable year, then \$950 is treated as distributed for purposes of satisfying the 90-percent distribution requirement of section 1247(a)(1)(A), and the amount of foreign taxes treated as distributed under this subdivision is \$95 (that is, \$100 multiplied by \$950/\$1,000).

(iii) If the amount of taxable income (computed without regard to subdivision (i) of this subparagraph) is zero, then all foreign taxes referred to in paragraph (a)(2) of this section which were paid during the taxable year shall be treated as distributed by the company on the last day of such taxable year. Thus, for example, if for a taxable year a foreign investment company has taxable income of \$500 (computed without deducting \$800 of foreign taxes paid during such year), the amount of taxable income computed without regard to subdivision (i) of this paragraph is zero, and the \$800 of foreign taxes is treated as distributed under this subdivision on the last day of the company's taxable year.

(2) *Effect on qualified shareholders*. The following rules apply to a qualified shareholder of a foreign investment company which makes a valid election under section 1247(f) for a taxable year:

(i) The qualified shareholder shall include in his gross income (in addition to taxable dividends actually received) his proportionate share of the foreign taxes referred to in paragraph (a)(2) of this section which were paid during such taxable year of the company, and shall treat such proportionate share as paid by him for purposes of the deduction under section 164(a) and the foreign tax credit under section 901. See, however, paragraph (c)(1) of this section for a limitation on the amount a shareholder may treat as his proportionate share of foreign taxes.

(ii) In respect of any distribution made (or treated as made under section 1247(a)(2)(B)) during the taxable year of the company and which is received by a qualified shareholder, the term *proportionate share of foreign taxes* means,

for purposes of this section, an amount which bears the same ratio to (a) the amount of the foreign taxes referred to in paragraph (a)(2) of this section which were paid during such taxable year of the company, as (b) the amount of such distribution to the shareholder out of the company's taxable income for such taxable year (determined without regard to subparagraph (1)(i) of this paragraph), bears to (c) the amount of such taxable income (also determined without regard to such subparagraph (1)(i)).

(iii) In respect of any distribution of foreign taxes treated as made under subparagraph (1)(iii) of this paragraph on the last day of the taxable year of the company, the term *proportionate share of foreign taxes* means, for purposes of this section, an amount which bears the same ratio to (a) the amount of foreign taxes referred to in paragraph (a)(2) of this section which were paid during such taxable year of the company, as (b) the fair market value of all shares of stock of the company held by such qualified shareholder on the last day of such taxable year, bears to (c) the fair market value of all such shares outstanding on such last day.

(iv) For purposes of the foreign tax credit, the qualified shareholder shall treat his proportionate share of foreign taxes as having been paid by him to the country in which the foreign investment company is created or organized.

(v) For purposes of the foreign tax credit, the qualified shareholder shall treat as gross income from sources within the country in which the foreign investment company is created or organized the sum of (a) his proportionate share of foreign taxes, (b) any dividend paid to him by such foreign investment company, and (c) his pro rata amount of distributed and undistributed portions of excess capital gains referred to in paragraph (a) of § 1.1247-3.

(vi)(a) In respect of a distribution made (or treated as made under section 1247(a)(2)(B)) during a taxable year of the company, a qualified shareholder shall consider his proportionate share of foreign taxes as having been received, and as having been paid, by him during his taxable year in which the

distribution is includible in his gross income.

(b) In respect of an amount of foreign taxes treated as distributed under subparagraph (1)(iii) of this paragraph on the last day of a taxable year of the company, the qualified shareholder shall consider his proportionate share of foreign taxes as having been received, and as having been paid, by him during his taxable year in which such last day falls.

(vii) If the qualified shareholder is a corporation, it shall not be deemed under section 902 to have paid any taxes paid by the foreign investment company to which the election under section 1247(f) applied.

(3) *Effect on nonqualified shareholders.* A shareholder who is not a qualified shareholder shall not include his proportionate share of foreign taxes in gross income, and shall not be entitled to treat such proportionate share as having been paid by him to a foreign country for purposes of the deduction under section 164(a) or, except to the extent that section 902 is applicable, for purposes of the foreign tax credit under section 901.

(4) *Example.* The application of paragraph (a) of this section and this paragraph may be illustrated by the following examples:

Example 1. (i) X Corporation, a foreign investment company incorporated in country C with 100,000 shares of stock outstanding, uses the calendar year as its taxable year. For 1964, X Corporation has the following income and pays the following foreign taxes:

Dividend income, minus operating expenses	\$675,000
Foreign income taxes paid:	
Withheld by country A	\$25,000
Withheld by country B	50,000
Income tax of country C	90,000
Total foreign income tax paid	165,000
Taxable income for purposes of section 1247(a)(1)(A), determined without regard to section 1247(f)	510,000

X Corporation distributes to its shareholders the amount of \$459,000 (i.e., 90 percent of \$510,000).

(ii) Assume that X Corporation validly elects the application of section 1247(f). Accordingly, X Corporation determines that its taxable income for purposes of section 1247(a)(1)(A) without any deduction for foreign income taxes paid or accrued is \$675,000 (\$510,000, plus \$165,000).

(iii) Assume that X Corporation intends to distribute the least amount which would satisfy the requirements of section 1247(a)(1)(A), as modified by the election under section 1247(f). Thus, the total amount X distributes is \$607,500, which consists of the sum of (a) \$459,000 actually distributed, that is, 90 percent of \$510,000 of taxable income (determined after the deduction for foreign taxes), plus (b) foreign taxes paid of \$148,500 which are treated as distributed, that is, 90 percent of \$165,000 of foreign taxes paid by X Corporation.

Example 2. Assume the same facts as in example (1) except that X Corporation distributes the entire \$510,000 in the following manner: On December 15, 1964, X Corporation distributes \$170,000 as a dividend of \$1.70 per share. On February 25, 1965, X Corporation distributes the remaining \$340,000 as a dividend of \$3.40 per share pursuant to an election under section 1247(a)(2)(B) to treat such distribution as if made in 1964. Assume that Brown, a qualified shareholder, uses the calendar year as his taxable year. The amount of \$0.55 per share (that is, \$165,000, multiplied by \$1.70/\$510,000) must be treated by Brown as foreign taxes paid by him in 1964 to country C and the amount of \$1.10 per share (that is, \$165,000 multiplied by \$3.40/\$510,000) must be similarly treated by Brown in 1965. The amount of \$2.25 per share (\$1.70 of dividends actually received plus \$0.55 representing foreign taxes paid) must be reported by Brown as income considered received in 1964 from country C, and the amount of \$4.50 per share (\$3.40 of dividends actually received plus \$1.10 representing foreign taxes paid) must be so reported by Brown in 1965.

Example 3. A foreign investment company organized under the laws of country C receives a dividend of \$1,000 from X Corporation, which is also organized under the laws of country C. Under the laws of country C, the foreign investment company would, if it so elects, be considered as having paid income tax in the amount of \$150 which X Corporation paid to country C with respect to the earnings from which the dividend was paid. If the foreign investment company were a domestic corporation, however, it would not be considered for purposes of section 901(b)(1) as having paid the tax actually paid by X Corporation. Accordingly, the election under section 1247(f) does not apply in respect of the \$150. The result would be the same if X Corporation was organized under the laws of any other foreign country to which it paid taxes and if the laws of country C permitted the foreign investment company to be considered as the payor of such taxes.

(c) *Notice to shareholders—(1) In general.* If, in the manner provided in paragraph (d) of this section, a foreign investment company makes an election with respect to the foreign tax credit

under section 1247(f), the company shall furnish to each shareholder a written notice mailed not later than 45 days after the close of the taxable year of the company for which the election is made, designating the shareholder's proportionate share of the foreign taxes referred to in paragraph (a)(2) of this section which were paid by the company during such taxable year. This notice may be combined with the written notice to shareholders described in paragraph (a)(3) of § 1.1247-3 relating to excess capital gains.

(2) *Application to shareholder.* For purposes of paragraph (b)(2) of this section, the amount which a shareholder may treat as his proportionate share of foreign taxes paid by the company shall not exceed the amounts so designated by the company in such written notice. If, however, an amount designated by the company in a notice exceeds the shareholder's proper proportionate share of such foreign taxes, the shareholder is limited to the amount correctly determined.

(d) *Manner of making election—(1) In general.* The election of a foreign investment company to have section 1247(f) apply for a taxable year shall be made by filing as part of its information return required by paragraph (c)(1) of § 1.1247-5 a Form 1118 modified so that it becomes a statement in support of the election made by the company under section 1247(f).

(2) *Irrevocability of election.* An election under section 1247(f) for a taxable year of a foreign investment company shall be made with respect to all foreign taxes referred to in paragraph (a)(2) of this section which were paid during such taxable year, and must be made not later than the time prescribed for filing the information return under paragraph (c)(1) of § 1.1247-5. Such election, if made, shall be irrevocable with respect to the distributions, and the foreign taxes with respect thereto, to which the election applies.

[T.D. 6798, 30 FR 1177, Feb. 4, 1965]

§ 1.1247-5 Information and record-keeping requirements.

(a) *General.* In order to carry out the purposes of section 1247, a foreign investment company shall keep the