

See 26 CFR §1.904-4T(c)(3) and (4) (revised as of April 1, 2009) for grouping rules applicable to taxable years beginning after December 31, 2002, and ending before April 20, 2009. For corresponding rules applicable to taxable years beginning before January 1, 2003, see 26 CFR §1.904-4(c)(2)(i) (revised as of April 1, 2006).

[T.D. 8214, 53 FR 27011, July 18, 1988]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.904-4, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

§ 1.904-4T Separate application of section 904 with respect to certain categories of income (temporary).

(a) *In general.* A taxpayer is required to compute a separate foreign tax credit limitation for income received or accrued in a taxable year that is described in section 904(d)(1)(A) (passive category income), 904(d)(1)(B) (general category income), or §1.904-4(m) (additional separate categories).

(b) *Passive category income*—(1) *In general.* The term *passive category income* means passive income and specified passive category income.

(2) *Passive income*—(i) *In general.* The term *passive income* means any—

(A) Income received or accrued by any person that is of a kind that would be foreign personal holding company income (as defined in section 954(c)) if the taxpayer were a controlled foreign corporation, including any amount of gain on the sale or exchange of stock in excess of the amount treated as a dividend under section 1248; or

(B) Amount includible in gross income under section 1293.

(ii) *Exceptions.* Passive income does not include any export financing interest (as defined in section 904(d)(2)(G) and paragraph (h) of this section), any high-taxed income (as defined in section 904(d)(2)(F) and paragraph (c) of this section), or any active rents and royalties (as defined in paragraph (b)(2)(iii) of this section). In addition, passive income does not include any income that would otherwise be passive but is characterized as income in another separate category under the look-through rules of section 904(d)(3), (d)(4), and (d)(6)(C) and the regulations

under those provisions. In determining whether any income is of a kind that would be foreign personal holding company income, the rules of section 864(d)(5)(A)(i) and (6) (treating related person factoring income of a controlled foreign corporation as foreign personal holding company income that is not eligible for the export financing income exception to the separate limitation for passive income) shall apply only in the case of income of a controlled foreign corporation (as defined in section 957). Thus, income earned directly by a United States person that is related person factoring income may be eligible for the exception for export financing interest.

(iii) *Active rents or royalties*—(A) *In general.* For rents and royalties paid or accrued after September 20, 2004, passive income does not include any rents or royalties that are derived in the active conduct of a trade or business, regardless of whether such rents or royalties are received from a related or an unrelated person. Except as provided in paragraph (b)(2)(iii)(B) of this section, the principles of section 954(c)(2)(A) and the regulations under that section shall apply in determining whether rents or royalties are derived in the active conduct of a trade or business. For this purpose, the term taxpayer shall be substituted for the term controlled foreign corporation if the recipient of the rents or royalties is not a controlled foreign corporation.

(B) *Active conduct of trade or business.* Rents and royalties are considered derived in the active conduct of a trade or business by a United States person or by a controlled foreign corporation (or other entity to which the look-through rules apply) for purposes of section 904 (but not for purposes of section 954) if the requirements of section 954(c)(2)(A) are satisfied by one or more corporations that are members of an affiliated group of corporations (within the meaning of section 1504(a), determined without regard to section 1504(b)(3)) of which the recipient is a member. For purposes of this paragraph (b)(2)(iii)(B), an affiliated group includes only domestic corporations and foreign corporations that are controlled foreign corporations in which domestic members of the affiliated

group own, directly or indirectly, at least 80 percent of the total voting power and value of the stock. For purposes of this paragraph (b)(2)(iii)(B), indirect ownership shall be determined under section 318 and the regulations under that section.

(iv) *Examples.* The following examples illustrate the application of paragraph (b)(2) of this section.

Example 1. P is a domestic corporation with a branch in foreign country X. P does not have any financial services income. For 2008, P has a net foreign currency gain that would not constitute foreign personal holding company income if P were a controlled foreign corporation because the gain is directly related to the business needs of P. The currency gain is, therefore, general category income to P because it is not income of a kind that would be foreign personal holding company income.

Example 2. Controlled foreign corporation S is a wholly-owned subsidiary of P, a domestic corporation. S is regularly engaged in the restaurant franchise business. P licenses trademarks, tradenames, certain know-how, related services, and certain restaurant designs for which S pays P an arm's length royalty. P is regularly engaged in the development and licensing of such property. The royalties received by P for the use of its property are allocable under the look-through rules of §1.904-5 to the royalties S receives from the franchisees. Some of the franchisees are unrelated to S and P. Other franchisees are related to S or P and use the licensed property outside of S's country of incorporation. S does not satisfy, but P does satisfy, the active trade or business requirements of section 954(c)(2)(A) and the regulations under that section. The royalty income earned by S with regard to both its related and unrelated franchisees is foreign personal holding company income because S does not satisfy the active trade or business requirements of section 954(c)(2)(A) and, in addition, the royalty income from the related franchisees does not qualify for the same country exception of section 954(c)(3). However, all of the royalty income earned by S is general category income to S under §1.904-4(b)(2)(iii) because P, a member of S's affiliated group (as defined therein), satisfies the active trade or business test (which is applied without regard to whether the royalties are paid by a related person). S's royalty income that is taxable to P under subpart F and the royalties paid to P are general category income to P under the look-through rules of §1.904-5(c)(1)(i) and (c)(3), respectively.

(3) *Specified passive category income* means—

(i) Dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States;

(ii) Taxable income attributable to foreign trade income (within the meaning of section 923(b)); or

(iii) Distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)).

(c) through (h)(2) [Reserved] For further guidance, see §1.904-4(c) through (h)(2).

(3) *Exception.* Unless it is received or accrued by a financial services entity, export financing interest shall be treated as passive category income if that income is also related person factoring income. For this purpose, related person factoring income is—

(i) Income received or accrued by a controlled foreign corporation that is income described in section 864(d)(6) (income of a controlled foreign corporation from a loan for the purpose of financing the purchase of inventory property of a related person); or

(ii) Income received or accrued by any person that is income described in section 864(d)(1) (income from a trade receivable acquired from a related person).

(h)(4) through (k) [Reserved] For further guidance, see §1.904-4(h)(3)(iii) through (k).

(l) *Priority rule.* Income that meets the definitions of a separate category described in paragraph (m) of this section and another category of income described in section 904(d)(2)(A)(i) and (ii) will be subject to the separate limitation described in paragraph (m) of this section and will not be treated as general category income described in section 904(d)(2)(A)(ii).

(m) [Reserved] For further guidance, see §1.904-4(m).

(n) *Effective/applicability date.* Paragraphs (a), (b), (h)(3), and (l) of this section shall apply to taxable years of United States taxpayers beginning after December 31, 2006 and ending on

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or after December 21, 2007, and to taxable years of a foreign corporation which end with or within taxable years of its domestic corporate shareholder beginning after December 31, 2006 and ending on or after December 21, 2007.

(o) *Expiration date.* The applicability of paragraphs (a), (b), (h)(3)(ii) and (l) of this section expires on December 20, 2010.

[T.D. 9260, 71 FR 24530, Apr. 25, 2006, as amended by T.D. 9368, 72 FR 72588, Dec. 21, 2007 T.D. 9452, 74 FR 27878, June 11, 2009]

§ 1.904-5 Look-through rules as applied to controlled foreign corporations and other entities.

(a) *Definitions.* For purposes of section 904(d)(3) and (4) and the regulations under section 904, the following definitions apply:

(1) The term *separate category* means, as the context requires, any category of income described in section 904(d)(1)(A) and (B) (or section 904(d)(1)(A), (B), (C), (D), (F), (G), (H), or (I) for taxable years beginning before January 1, 2007) and in § 1.904-4T(b) (or § 1.904-4(e) for taxable years beginning before January 1, 2007), any category of income described in § 1.904-4(m), or any category of earnings and profits to which income described in such provisions is attributable.

(2) The term *controlled foreign corporation* has the meaning given such term by section 957 (taking into account the special rule for certain captive insurance companies contained in section 953(c)).

(3) The term *United States shareholder* has the meaning given such term by section 951(b) (taking into account the special rule for certain captive insurance companies contained in section 953(c)), except that for purposes of this section, a United States shareholder shall include any member of the controlled group of the United States shareholder. For this purpose the controlled group is any member of the affiliated group within the meaning of section 1504(a)(1) except that “more than 50 percent” shall be substituted for “at least 80 percent” wherever it appears in section 1504(a)(2). For taxable years beginning before January 1, 2001, the preceding sentence shall be

applied by substituting “50 percent” for “more than 50 percent”.

(4) The term *noncontrolled section 902 corporation* means any foreign corporation with respect to which the taxpayer meets the stock ownership requirements of section 902(a), or, with respect to a lower-tier foreign corporation, the taxpayer meets the requirements of section 902(b). Except as provided in section 902 and the regulations under that section and paragraphs (i)(3) and (i)(4) of this section, a controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distributions out of its earnings and profits for periods during which it was a controlled foreign corporation. In the case of a partnership owning a foreign corporation, the determination of whether a taxpayer meets the ownership requirements of section 902(a) or (b) will be made with respect to the taxpayer’s indirect ownership, and not the partnership’s direct ownership, in the foreign corporation. See section 902(c)(7).

(b) *In general.* Except as otherwise provided in section 904(d)(3) and (4) and this section, dividends, interest, rents, and royalties received or accrued by a taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as general category income. See paragraph (c)(4)(iii) of this section for the treatment of dividends received by a domestic corporation from a noncontrolled section 902 corporation in which the domestic corporation meets the stock ownership requirements of section 902(a).

(c) *Rules for specific types of inclusions and payments—(1) Subpart F inclusions—*

(i) *Rule.* Any amount included in gross income under section 951(a)(1)(A) shall be treated as income in a separate category to the extent the amount so included is attributable to income received or accrued by the controlled foreign corporation that is described as income in such category. For purposes of this § 1.904-5, income shall be characterized under the rules of § 1.904-4 prior to the application of the rules of paragraph (c) of this section. For rules concerning inclusions under section 951(a)(1)(B), see paragraph (c)(4)(i) of this section.