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amount by which A's qualified investments in foreign base company shipping operations at December 31, 1981 ($80,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1982 ($70,000).

Example 4. The facts are the same as in example 1. Assume further that on September 30, 1979, M sells 40 percent of the only class of stock of A to N Corporation, a domestic corporation. N uses the calendar year as a taxable year. A remains a controlled foreign corporation immediately after such sale of its stock. A's qualified investments in foreign base company shipping operations at December 31, 1980, amount to $90,000. The changes in A Corporation's qualified investments in foreign base company shipping operations occurring in its taxable year 1979 are considered to be zero with respect to the 40-percent stock interest acquired by N Corporation. The entire $20,000 reduction in A Corporation's qualified investments in foreign base company shipping operations which occurs during the taxable year 1979 is taken into account by M for purposes of paragraph (c)(1) of this section in determining its tax liability for the taxable year 1978. A's increase in qualified investments in foreign base company shipping operations for the taxable year 1979 with respect to the 60-percent stock interest retained by M is $6,000 and is determined by ascertaining M's pro rata share (60 percent) of the amount by which A's qualified investments in foreign base company shipping operations at December 31, 1980 ($90,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1979 ($80,000). N does not make an election under section 955(b)(3) in its return for its taxable year 1980. Corporation A's increase in qualified investments in foreign base company shipping 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 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

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. See §1.956–1(e)(6) for a special rule for determining amounts attributable to United States property acquired as the result of certain nonrecognition transactions.

(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.

(5) [Reserved] For further guidance, see §1.956–1T(e)(5).

(6) *Adjusted basis of property acquired in certain nonrecognition transactions*—(i) *Scope.* This paragraph (e)(6) provides rules for determining, solely for purposes of applying section 956, the adjusted basis of specified United States property acquired by a controlled foreign corporation pursuant to an exchange in which the controlled foreign corporation's basis in such specified United States property is determined under section 362(a). This paragraph (e)(6) also applies if specified United States property, the adjusted basis in which has been determined under these regulations, is transferred (in one or more subsequent exchanges) to a related person (within the meaning of section 954(d)(3)), pursuant to one or more exchanges in which the related person's adjusted basis in such property is determined, in whole or in part, by reference to the transferor controlled foreign corporation's adjusted basis in such property.

(ii) *Definition of specified United States property.* For purposes of this paragraph (e)(6), *specified United States property* is stock of a domestic corporation described in section 956(c)(1)(B) or an obligation of a domestic corporation described in section 956(c)(1)(C) that is acquired by a controlled foreign corporation from the domestic issuing corporation. Specified United States property does not include property described in section 956(c)(2).

(iii) *Adjusted basis of specified United States property.* Solely for purposes of applying section 956, the adjusted basis of specified United States property acquired by a controlled foreign corporation in connection with an exchange to which this paragraph (e)(6) applies shall be no less than the fair market value of any property transferred by the controlled foreign corporation in exchange for such specified United States property. For purposes of this paragraph (e)(6), the term *property* has the meaning set forth in section 317(a), but also includes any liability that is assumed by the controlled foreign corporation in connection with the exchange notwithstanding the application of section 357(a). The assumption of a liability by the controlled foreign corporation in connection with the exchange will be considered the transfer of property. The fair market value of such property will be the amount of the liability assumed. The fair market value of any property transferred by the controlled foreign corporation in exchange for the specified United States property shall be determined at the time of the exchange.

(iv) *Timing.* For purposes of §1.956–2(d)(1)(i)(a), a controlled foreign corporation that acquires specified United States property in an exchange to which this paragraph (e)(6) applies acquires an adjusted basis in such property at the time of the controlled foreign corporation's exchange of property for such specified United States property.

(v) *Transfers to related persons.* If a controlled foreign corporation transfers specified United States property, the adjusted basis in which has been determined under this paragraph (e)(6), to a related person (within the meaning of section 954(d)(3)) (related person

transferee) in one or more exchanges pursuant to which the related person transferee's adjusted basis in such specified United States property is determined, in whole or in part, by reference to the controlled foreign corporation's adjusted basis in such specified United States property, then, solely for purposes of applying section 956 following such exchange, the controlled foreign corporation's adjusted basis in any United States property received in the exchange (or exchanges) shall be no less than the aggregate adjusted basis of the specified United States property as determined under paragraph (e)(6)(iii) of this section, and the related person transferee's adjusted basis in such specified United States property shall be no less than the adjusted basis of such specified United States property in the hands of the controlled foreign corporation as determined under paragraph (e)(6)(iii) of this section. This paragraph (e)(6)(v) shall also apply in the case of one or more successive transfers of the specified United States property by a related person transferee to one or more persons related to the controlled foreign corporation (within the meaning of section 954(d)(3)). This paragraph (e)(6)(v) shall apply regardless of whether a subsequent transfer was part of a plan (or series of related transactions) that includes the controlled foreign corporation's acquisition of the specified United States property.

(vi) *Examples*. The rules of this paragraph (e)(6) are illustrated by the following examples:

Example 1. (i) *Facts*. USP, a domestic corporation, is the common parent of an affiliated group that joins in the filing of a consolidated return. USP owns 100 percent of the stock of US1 and US2, both domestic corporations and members of the USP consolidated group. US1 owns 100 percent of the stock of CFC, a controlled foreign corporation. US2 issues $100x of its stock to CFC in exchange for $10x of CFC stock and $90x cash. US2's transfer of its stock to CFC is described in section 351, US2 recognizes no gain in the exchange under section 1032(a), and CFC's basis in the US2 stock acquired in the exchange is determined under section 362(a).

(ii) *Analysis*. The US2 stock acquired by CFC in the exchange constitutes specified United States property under paragraph (e)(6)(ii) of this section because CFC acquires the US2 stock from US2, the issuing corporation. Therefore, because CFC's adjusted basis in the US2 stock is determined under section 362(a), then for purposes of applying section 956, CFC's adjusted basis in the US2 stock shall, under paragraph (e)(6)(iii) of this section, be no less than $90x, the fair market value of the property exchanged by CFC for the US2 stock (the $10x of CFC stock issued in the exchange does not constitute property for purposes of paragraph (e)(6)(iii) of this section). Pursuant to paragraph (e)(6)(iv) of this section, for purposes of §1.956–2(d)(1)(i)(a) CFC shall be treated as acquiring its adjusted basis of no less than $90x in the US2 stock at the time of its transfer of property to US2 in exchange for the US2 stock. The result would be the same if, instead of CFC transferring $90x of cash to US2 in the exchange, CFC assumes a $90x liability of US2.

Example 2. (i) *Facts*. USP, a domestic corporation, owns 100 percent of the stock of USS, a domestic corporation. USP also owns 100 percent of the stock of CFC, a controlled foreign corporation. USP's adjusted basis in its USS stock equals the fair market value of the USS stock, or $100x. USP transfers its USS stock to CFC in exchange for $100x of CFC stock. USP's transfer of its USS stock to CFC is described in section 351, USP recognizes no gain in the exchange under section 351(a), and CFC's adjusted basis in the USS stock acquired in the exchange, determined under section 362(a), equals $100x.

(ii) *Analysis*. The USS stock acquired by CFC in the exchange does not constitute specified United States property under paragraph (e)(6)(ii) of this section because CFC acquires the USS stock from USP. Therefore, CFC's adjusted basis in the USS stock, for purposes of section 956, is not determined under this paragraph (e)(6). Instead, CFC's adjusted basis in the USS stock is determined under the general rule of section 956(a) and under paragraphs (e)(1) through (4) of this section. As determined under section 362(a), CFC's adjusted basis in the USS stock is $100x.

Example 3. (i) *Facts*. USP, a domestic corporation, owns 100 percent of the stock of CFC1, a controlled foreign corporation. CFC1 holds specified United States property (within the meaning of paragraph (e)(6)(ii) of this section) with an adjusted basis of $30x for purposes of applying section 956 that was determined under paragraph (e)(6)(iii) of this section. CFC1 owns 100 percent of the stock of CFC2, a controlled foreign corporation. CFC1 transfers the specified United States property to CFC2 in an exchange described in section 351. CFC2's adjusted basis in the specified United States property is determined under section 362(a).

(ii) *Analysis*. In the section 351 exchange, CFC1 transferred specified United States property to CFC2 with an adjusted basis that was determined under paragraph (e)(6)(iii) of

this section. Further, CFC2's adjusted basis in the specified United States property is determined under section 362(a) by reference, in whole or in part, to CFC1's adjusted basis in such property. Therefore, for purposes of applying section 956, pursuant to paragraph (e)(6)(v) of this section CFC2's adjusted basis in the specified United States property shall be no less than $30x. Paragraph (e)(6)(v) of this section would also apply if CFC2 subsequently transfers the specified United States property to another person related to CFC1 (within the meaning of section 954(d)(3)) if such related person's adjusted basis in the specified United States property is determined by reference, in whole or in part, to CFC2's adjusted basis in such property. See also §1.956–1T(b)(4) if one of the principal purposes of CFC1's transfer of property to CFC2 was the avoidance of the application of section 956 with respect to CFC1.

(vii) *Effective/applicability dates*. This paragraph (e)(6) applies to property acquired in exchanges occurring on or after June 24, 2011. For transactions that occur prior to June 24, 2011, see §1.956–1T(e)(6) as contained in 26 CFR Part 1 revised as of April 1, 2011.

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

[T.D. 6704, 29 FR 2600, Feb. 20, 1964, as amended by T.D. 6795, 30 FR 942, Jan. 29, 1965; T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 8209, 53 FR 22171, June 14, 1988; T.D. 9402, 73 FR 35582, June 24, 2008; T.D. 9630, 76 FR 36994, June 24, 2011]

§ 1.956–1T Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property (temporary).

(a) [Reserved]

(b)(1)–(3) [Reserved]

(4) *Treatment of certain investments of earnings in United States Property*—(i) *Special rule*. For purposes of §1.956–1(b)(1) of the regulations, a controlled foreign corporation will be considered to hold indirectly (A) the investments in United States property held on its behalf by a trustee or a nominee or (B) at the discretion of the District Director, investments in U.S. property acquired by any other foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application of section 956 with respect to the controlled foreign corporation. For purposes of this paragraph (b), a foreign corporation will be controlled by the controlled foreign corporation if the foreign corporation and the controlled foreign corporation are related parties under section 267(b). In determining for purposes of this paragraph (b) whether two or more corporations are members of the same controlled group under section 267(b)(3), a person is considered to own stock owned directly by such person, stock owned with the application of section 1563(e)(1), and stock owned with the application of section 267(c). The following examples illustrate the application of this paragraph.

Example 1. P, a domestic corporation, owns all of the outstanding stock of FS1, a controlled foreign corporation, and all of the outstanding stock of FS2, also a controlled foreign corporation. FS1 sells products to FS2 in exchange for trade receivables due in 60 days. FS2 has no earnings and profits. FS1 has substantial accumulated earnings and profits. FS2 loans to P an amount equal to the debt it owes FS1. FS2 pays the trade receivables according to the terms of the receivables. FS1 will not be considered to hold indirectly the investment in United States property under this paragraph (b)(4), because there was no transfer of funds to FS2.

Example 2. The facts are the same as in Example 1, except that FS2 does not pay the receivables. FS1 is considered to hold indirectly the investment in United States property under this paragraph (b)(4), because there was a transfer of funds to FS2, a principal purpose of which was to avoid the application of section 956 to FS1.

(ii) *Effective date*. This section is effective June 14, 1988, with respect to investments made on or after June 14, 1988.

(c)–(d) [Reserved]

(e)(1)–(4) [Reserved]

(5) *Exclusion for certain recourse obligations*. For purposes of §1.956–1(e)(1) of the regulations, in the case of an investment in United States property consisting of an obligation of a related person, as defined in section 954(d)(3) and paragraph (e) of §1.954–1, a liability will not be recognized as a specific charge if the liability representing the charge is with recourse with respect to the general credit or other assets of the