§ 1.884–1 Branch profits tax.

(b) Transition rule.

[26 CFR Ch. I (4–1–13 Edition)]

(1) General rule. A foreign corporation shall be liable for a branch profits tax in an amount equal to 30 percent of the foreign corporation’s dividend equivalent amount for the taxable year. The branch profits tax shall be in addition to the tax imposed by section 882 and shall be reported on a foreign corporation’s income tax return for the taxable year. The tax shall be due and payable as provided in section 6151 and such other provisions of Subtitle F of the Internal Revenue Code as apply to the income tax liability of corporations. However, no estimated tax payments shall be due with respect to the foreign corporation’s liability for the branch profits tax. See paragraph (g) of this section for the application of the branch profits tax to corporations that are residents of countries with which the United States has an income tax treaty, and §1.884–2T for the effect on the branch profits tax of the termination or incorporation of a U.S. trade or business, or the liquidation or reorganization of a foreign corporation or its domestic subsidiary.

(2) Dividend equivalent amount. The term “dividend equivalent amount” means a foreign corporation’s effectively connected earnings and profits (“ECEP”), as defined in paragraph (f)(1) of this section) for the taxable year, adjusted pursuant to paragraph (b) (2) or (3) of this section, as applicable. The dividend equivalent amount cannot be less than zero.

(3) Adjustment for increase in U.S. net equity. If a foreign corporation’s U.S. net equity (as defined in paragraph (c) of this section) as of the close of the taxable year exceeds the foreign corporation’s U.S. net equity as of the close of the taxable year, then, for purposes of computing the foreign corporation’s ECEP for the taxable year, the foreign corporation’s ECEP shall be reduced (but not below zero) by the amount of such excess.

(4) Adjustment for decrease in U.S. net equity. If a foreign corporation’s U.S. net equity (as defined in paragraph (c) of this section) as of the close of the taxable year is less than the foreign corporation’s U.S. net equity as of the close of the preceding taxable year, then, for purposes of computing the foreign corporation’s dividend equivalent amount for the taxable year, the foreign corporation’s ECEP for the taxable year shall be increased by the amount of such difference.

(4) Examples. The principles of paragraph (b) (2) and (3) of this section are illustrated by the following examples.

Example 1. Reinvestment of all ECEP. Foreign corporation A, a calendar year taxpayer, had $1,000 U.S. net equity as of the close of 1986 and $100 of ECEP for 1986. A acquires $100 of additional U.S. assets during 1987 and its U.S. net equity as of the close of 1987 is $1,100. In computing A’s dividend equivalent amount for 1987, A’s ECEP of $100 is reduced under paragraph (b)(2) of this section by the $100 increase in U.S. net equity between the close of 1986 and the close of 1987. A has no dividend equivalent amount for 1987.

Example 2. Partial reinvestment of ECEP. Assume the same facts as in Example 1 except that A acquires $40 (rather than $100) of U.S. assets during 1987 and its U.S. net equity as of the close of 1987 is $1,040. In computing A’s dividend equivalent amount for 1987, A’s ECEP of $100 is reduced under paragraph (b)(2) of this section by the $40 increase in U.S. net equity between the close of 1986 and the close of 1987. A has a dividend equivalent amount of $60 for 1987.

Example 3. Disinvestment of prior year’s ECEP. Assume the same facts as in Example 1 for 1987. A has no ECEP for 1988. A’s U.S. net equity decreases by $40 (to $1,000) as of the close of 1988. A has a dividend equivalent amount of $40 for 1988.
amount of $40 for 1988, even though it has no ECEP for 1988. A’s ECEP of $0 for 1988 is increased under paragraph (b)(3)(i) of this section by the $40 reduction in U.S. net equity (subject to the limitation in paragraph (b)(3)(ii) of this section of $100 of accumulated ECEP).

Example 4. Accumulated ECEP limitation. Assume the same facts as in Example 2 for 1987. For 1988, A has $125 of ECEP and its U.S. net equity decreases by $50. A’s U.S. net equity as of the close of 1988 is $950 ($1,000–$50). In computing A’s dividend equivalent amount for 1988, the $125 of ECEP for 1988 is not increased under paragraph (b)(3)(i) of this section by the decrease in U.S. net equity during 1988. Rather, the increase in ECEP resulting from a decrease in U.S. net equity is limited to A’s accumulated ECEP as of the beginning of 1988. A had $100 of ECEP for 1987 and a dividend equivalent amount of $60 for that year, so A had $40 of accumulated ECEP as of the beginning of 1988. The increase in ECEP resulting from a decrease in U.S. net equity is thus limited to $40, and the dividend equivalent amount for 1988 is $165 ($125 ECEP + $40 decrease in U.S. net equity).

Example 5. Effect of deficits in ECEP. Foreign corporation A, a calendar year taxpayer, has $150 of accumulated ECEP as of the beginning of 1991 ($200 aggregate ECEP less $50 aggregate dividend equivalent amounts for years preceding 1991). A has U.S. net equity of $450 as of the close of 1990, U.S. net equity of $350 as of the close of 1991 (i.e., a $100 decrease in U.S. net equity) and a $90 deficit in ECEP for 1991. A’s dividend equivalent amount is $10 for 1991, i.e., A’s deficit of $90 in ECEP for 1991 increased by $100, the decrease in A’s U.S. net equity during 1991. A portion of the reduction in U.S. net equity in 1991 ($90) is attributable to A’s deficit in ECEP for that year. The reduction in U.S. net equity in 1991 ($100) triggers a dividend equivalent amount only to the extent it exceeds the $90 current year deficit in ECEP for 1991. As of the beginning of 1992, A has $50 of accumulated ECEP (i.e., $110 aggregate dividend equivalent less $60 aggregate dividend equivalent amounts for years preceding 1992).

Example 6. Nimble dividend equivalent amount. Foreign corporation A, a calendar year taxpayer, had a deficit in ECEP of $100 for 1987 and $100 for 1988, and has $90 of ECEP for 1989. A had $2,000 U.S. net equity as of the close of 1988 and has $2,000 U.S. net equity as of the close of 1988. A has a dividend equivalent amount of $90 for 1989, its ECEP for the year, even though it has a net deficit of $110 in ECEP for the period 1987–1989.

(c) U.S. net equity.—(1) Definition. The term “U.S. net equity” means the aggregate amount of the U.S. assets (as defined in paragraphs (c)(2) and (d)(1) of this section) of a foreign corporation as of the determination date (as defined in paragraph (c)(3) of this section), reduced (including below zero) by the U.S. liabilities (as defined in paragraph (e) of this section) of the foreign corporation as of the determination date.

(2) Definition of the amount of a U.S. asset.—(i) In general. For purposes of this section, the term “amount of a U.S. asset” means the U.S. asset’s adjusted basis for purposes of computing earnings and profits (“E&P basis”) multiplied by the proportion of the E&P basis of the foreign corporation that is treated as a U.S. asset under paragraphs (d) (1) through (4) of this section. The amount of a U.S. asset that is money shall be its face value. See paragraph (d)(6) of this section for rules concerning the computation of the E&P basis of a U.S. asset.

(ii) Bad debt reserves. A bank described in section 585(a)(2)(B) (without regard to the second sentence thereof) that uses the reserve method of accounting for bad debts for U.S. federal income tax purposes shall decrease the amount of loans that qualify as U.S. assets by any reserve that is permitted under section 585.

(3) Definition of determination date. For purposes of this section, the term “determination date” means the close of the day on which the amount of U.S. net equity is required to be determined. Unless otherwise provided, the U.S. net equity of a foreign corporation is required to be determined as of the close of the foreign corporation’s taxable year.

(d) U.S. assets.—(1) Definition of a U.S. asset.—(General rule. Except as provided in paragraph (d)(5) of this section, the term “U.S. asset” means an asset of a foreign corporation (other than an interest in a partnership, trust, or estate) that is held by the corporation as of the determination date if—

(A) All income produced by the asset on the determination date is ECI (as defined in paragraph (d)(1)(ii) of this section) (or would be ECI if the asset produced income on that date); and

(B) All gain from the disposition of the asset would be ECI if the asset were disposed of on that date and the disposition produced gain.

For purposes of determining whether income or gain from an asset would be
ECI under this paragraph (d)(1)(i), it is immaterial whether the asset is of a type that is unlikely to, or cannot, produce income or gain. For example, money may be a U.S. asset although it does not produce income or gain. In the case of an asset that does not produce income, however, the determination of whether income from the asset would be ECI shall be made under the principles of section 864 and the regulations thereunder, but without regard to §1.864-4(c)(2)(iii)(b). For purposes of determining whether an asset is a U.S. asset under this paragraph (d)(1), a foreign corporation may presume, unless it has reason to know otherwise, that gain from the sale of personal property (including inventory property) would be U.S. source if gain from the sale of that type of property would ordinarily be attributable to an office or other fixed place of business of the foreign corporation within the United States (within the meaning of section 865(e)(2)).

(ii) Special rules for assets not described in paragraph (d)(1)(i) of this section. An asset of a foreign corporation that is held by the corporation as of the determination date and is not described in paragraph (d)(1)(i) of this section shall be treated as a U.S. asset to the extent provided in paragraph (d)(2) of this section (relating to special rules for certain assets, including assets that produce income or gain at least a portion of which is ECI), and in paragraphs (d) (3) and (4) of this section (relating to special rules for interests in a partnership, trust, and estate).

(iii) Definition of ECI. For purposes of the regulations under section 884, the term “ECI” means income that is effectively connected with the conduct of a trade or business in the United States and income that is treated as effectively connected with the conduct of a trade or business in the United States under any provision of the Code. The term “ECI” also includes all income that is or is treated as effectively connected with the conduct of a U.S. trade or business whether or not the income is included in gross income (for example, interest income earned with respect to tax-exempt bonds).

(2) Special rules for certain assets—(i) Depreciable and amortizable property. An item of depreciable personal property or an item of amortizable intangible property shall be treated as a U.S. asset of a foreign corporation in the same proportion that the amount of the depreciation or amortization with respect to the item of property that is allowable as a deduction, or is includible in cost of goods sold, for the taxable year in computing the effectively connected taxable income of the foreign corporation bears to the total amount of depreciation or amortization computed for the taxable year with respect to the item of property.

(ii) Inventory. An item or pool of inventory property (as defined in section 865(i)(1)) shall be treated as a U.S. asset in the same proportion as the amount of gross receipts from the sale or exchange of such property for the three preceding taxable years (or for such part of the three-year period as the corporation has been in existence) that is effectively connected with the conduct of a U.S. trade or business bears to the total amount of gross receipts from the sale or exchange of such property during such period (or part thereof). If a foreign corporation has not sold or exchanged such property during such three-year period (or part thereof), then the property shall be treated as a U.S. asset in the same proportion that the anticipated amount of gross receipts from the sale or exchange of the property that is reasonably anticipated to be ECI bears to the anticipated total amount of gross receipts from the sale or exchange of the property.

(iii) Installment obligations. An installment obligation received in connection with an installment sale (as defined in section 453(b)) for which an election under section 453(d) has not been made shall be treated as a U.S. asset to the extent that it is received in connection with the sale of a U.S. asset. If an obligation is received in connection with the sale of an asset that is held by a U.S. asset, it shall be treated as a U.S. asset in its entirety. If a single obligation is received in connection with the sale of an asset that is in part a U.S. asset under the rules of paragraphs (d) (2) through (4) of this section, or in connection with the sale of several assets including one or more
non-U.S. assets, the obligation shall be treated as a U.S. asset in the same proportion as—

(A) The sum of the amount of gain from the installment sale that would be ECI if the obligation were satisfied in full on the determination date and the adjusted basis of the obligation on such date (as determined under section 453B) attributable to the amount of gain that would be ECI bears to

(B) The sum of the total amount of gain from the sale if the obligation were satisfied in full and the adjusted basis of the obligation on such date (as determined under section 453B).

However, the obligation will only be treated as a U.S. asset if the interest income or original issue discount with respect to the obligation is ECI or the foreign corporation elects to treat the interest or original issue discount as ECI in the same proportion that the obligation is treated as a U.S. asset. A foreign corporation may elect to treat interest income or original issue discount as ECI by reporting such interest income or original issue discount as ECI on its income tax return or an amended return for the taxable year. See paragraph (d)(6)(ii) of this section to determine the E&P basis of an installment obligation for purposes of this paragraph (d)(2)(iii).

(iv) Receivables—(A) Receivables arising from the sale or exchange of inventory property. An account or note receivable (whether or not bearing stated interest) with a maturity not exceeding six months that arises from the sale or exchange of inventory property (as defined in section 865(i)(1)) shall be treated as a U.S. asset in the proportion determined under paragraph (d)(2)(iii) of this section as if the receivable were an installment obligation.

(B) Receivables arising from the performance of services or leasing of property. An account or note receivable (whether or not bearing stated interest) with a maturity not exceeding six months that arises from the performance of services or the leasing of property in the ordinary course of a foreign corporation’s trade or business shall be treated as a U.S. asset in the same proportion that the amount of gross income represented by the receivable that is ECI bears to the total amount of gross income represented by the receivable. For purposes of this paragraph (d)(2)(iv)(B), the amount of income represented by a receivable shall not include interest income or original issue discount.

(v) Bank and other deposits. A deposit or credit balance with a person described in section 871(i)(3) or a Federal Reserve Bank that is interest-bearing shall be treated as a U.S. asset if all income derived by the foreign corporation with respect to the deposit or credit balance during the taxable year is ECI. Any other deposit or credit balance shall only be treated as a U.S. asset if the deposit or credit balance is needed in a U.S. trade or business with the meaning of §1.864–4(c)(2)(iii)(a).

(vi) Debt instruments. A debt instrument, as defined in section 1275(a)(1) (other than an asset treated as a U.S. asset under any other subdivision of this paragraph (d)) shall be treated as a U.S. asset, notwithstanding the fact that gain from the sale or exchange of the obligation on the determination date would not be ECI, if—

(A) All income derived by the foreign corporation from such obligation during the taxable year is ECI; and

(B) The yield for the period that the instrument was held during the taxable year equals or exceeds the Applicable Federal Rate for instruments of similar type and maturity.

Shares in a regulated investment company that purchases solely instruments that, under this paragraph (d)(2)(vi), would be U.S. assets if held directly by the foreign corporation shall also be treated as a U.S. asset.

(vii) Securities held by a foreign corporation engaged in a banking, financing or similar business. Securities described in §1.864–4(c)(5)(i)(b)(2) held by a foreign corporation engaged in the active conduct of a banking, financing, or similar business in the United States during the taxable year shall be treated as U.S. assets in the same proportion that income, gain, or loss from such securities is ECI for the taxable year under §1.864–4(c)(5)(ii).

(viii) Federal income taxes. An overpayment of Federal income taxes shall be treated as a U.S. asset to the extent that the tax would reduce a foreign corporation’s ECEP for the taxable
year but for the fact that the tax does not accrue during the taxable year.

(ix) Losses involving U.S. assets. A foreign corporation that sustains, with respect to a U.S. asset, a loss for which a deduction is not allowed under section 165 (in whole or in part) because there exists a reasonable prospect of recovering compensation for the loss shall be treated as having a U.S. asset ("loss property") from the date of the loss in the same proportion that the asset was treated as a U.S. asset immediately before the loss. See paragraph (d)(6)(iv) of this section to determine the E&P basis of the loss property.

(x) Ruling for involuntary conversion. If property that is a U.S. asset of a foreign corporation is compulsorily or involuntarily converted into property not similar or related in service or use (within the meaning of section 1033), the foreign corporation may apply to the Commissioner for a ruling to determine its U.S. assets for the taxable year of the involuntary conversion.

(x) Examples. The principles of paragraphs (c) and (d)(1) and (2) of this section are illustrated by the following examples.

Example 1. Depreciable property. Foreign corporation A, a calendar year taxpayer, is engaged in a trade or business in the United States. A owns equipment that is used in its manufacturing business in country X and in the United States. Under §1.861–8, A's depreciation deduction with respect to the equipment is $10 for 1993. To determine the amount of A's U.S. asset at the close of 1993, the equipment's $90 E&P basis at the close of 1993 is multiplied by 70 percent (the proportion of the asset that is a U.S. asset). The amount of the U.S. asset as of the close of 1993 is $63.

Example 2. U.S. real property interest connected to a U.S. business. FC is a foreign corporation that is a bank, within the meaning of section 864(a)(2)(B) (without regard to the second sentence thereof), and is engaged in the business of taking deposits and making loans through its branch in the United States. In 1996, FC makes a loan in the ordinary course of its lending business in the United States, securing the loan with a mortgage on the U.S. real property being financed by the borrower. In 1997, after the borrower has defaulted on the loan, FC takes title to the real property that secures the loan. On December 31, 1997, FC continues to hold the property, classifying it on its financial statement as Other Real Estate Owned. Because all income and gain from the property would be ECI to FC under the principles of section 864(c)(2), the U.S. real property constitutes a U.S. asset within the meaning of paragraph (d) of this section.

Example 3. U.S. real property interest not connected to a U.S. business. Foreign corporation A owns a condominium apartment in the United States. Assume that holding the apartment does not constitute a U.S. trade or business and the foreign corporation has not made an election under section 882(d) to treat income with respect to the property as ECI. The condominium apartment is not a U.S. asset of A because the income, if any, from the asset would not be ECI. However, the dispositions by A of the condominium apartment at a gain will give rise to ECP.

Example 4. Stock in a domestically-controlled REIT. As an investment, foreign corporation A owns stock in a domestically-controlled REIT, within the meaning of section 897(h)(4)(B). Under section 897(h)(2), gain on disposition of stock in the REIT is not treated as ECI. For this reason the stock does not qualify as a U.S. asset under paragraph (d)(1) of this section even if dividend distributions from the REIT are treated as ECI. Thus, A will have a dividend equivalent amount based on the ECP attributable to a distribution of ECI from the REIT, even if A invests the proceeds from the dividend in additional stock of the REIT. (Stock in a REIT that is not a domestically-controlled REIT is also not a U.S. asset. See §1.884–1(d)(5)).

Example 5. Section 864(c)(7) property. Foreign corporation A is engaged in the equipment leasing business in the United States and Canada. A transfers the equipment leased by its U.S. trade or business to its Canadian business after the equipment is fully depreciated in the United States. The Canadian business sells the equipment two years later. Section 864(c)(7) would treat the gain on the disposition of the equipment by A as taxable under section 882 as if the sale occurred immediately before the equipment was transferred to the Canadian business. The equipment would not be treated as a U.S. asset even if the gain was ECI because the income from the equipment in the year of the sale in Canada would not be ECI.

(3) Interest in a partnership—(1) In general. A foreign corporation that is a partner in a partnership must take into account its interest in the partnership (and not the partnership assets) in determining its U.S. assets.
For purposes of determining the proportion of the partnership interest that is a U.S. asset, a foreign corporation may elect to use either the asset method described in paragraph (d)(3)(ii) of this section or the income method described in paragraph (d)(3)(iii) of this section.

(ii) Asset method—(A) In general. A partner’s interest in a partnership shall be treated as a U.S. asset in the same proportion that the sum of the partner’s proportionate share of the adjusted bases of all partnership assets as of the determination date, to the extent that the assets would be treated as U.S. assets if the partnership were a foreign corporation, bears to the sum of the partner’s proportionate share of all partnership assets as of the determination date. Generally a partner’s proportionate share of a partnership asset is the same as its proportionate share of all items of income, gain, loss, and deduction that may be generated by the asset.

(B) Non-uniform proportionate shares. If a partner’s proportionate share of all items of income, gain, loss, and deduction that may be generated by a single asset of the partnership throughout the period that includes the taxable year of the partner is not uniform, then, for purposes of determining the partner’s proportionate share of the adjusted basis of that asset, a partner must take into account the portion of the adjusted basis of the asset that reflects the partner’s economic interest in that asset. A partner’s economic interest in an asset of the partnership must be determined by applying the following presumptions. These presumptions may, however, be rebutted if the partner or the Internal Revenue Service shows that the presumption is inconsistent with the partner’s true economic interest in the asset during the corporation’s taxable year.

(1) If a partnership asset ordinarily generates no directly identifiable income, for example because the asset contributes equally to the generation of all the income of the partnership (such as an asset used in general and administrative functions), a partner’s economic interest in the asset is determined by reference to its proportionate share of the total deductions that may be generated by the asset for the partnership’s taxable year ending with or within the partner’s taxable year.

(2) For other partnership assets not described in paragraph (d)(3)(ii)(B) (1) or (2) of this section, a partner’s economic interest in the asset is determined by reference to its proportionate share of the total gain or loss to which it would be entitled if the asset were sold at a gain or loss in the partnership’s taxable year ending with or within the partner’s taxable year.

(C) Partnership election under section 754. If a partnership files an election in accordance with section 754, then for purposes of this paragraph (d)(3)(ii), the basis of partnership property shall reflect adjustments made pursuant to sections 734 (relating to distributions of property to a partner) and 743 (relating to the transfer of an interest in a partnership). However, adjustments made pursuant to section 743 may be made with respect to a transferee partner only.

(iii) Income method. Under the income method, a partner’s interest in a partnership shall be treated as a U.S. asset in the same proportion that its distributive share of partnership ECI for the partnership’s taxable year that ends with or within the partner’s taxable year bears to its distributive share of all partnership income for that taxable year.

(iv) Manner of election—(A) In general. In determining the proportion of a foreign corporation’s interest in a partnership that is a U.S. asset, a foreign corporation must elect one of the methods described in paragraph (d)(3) of this section on a timely filed return for the first taxable year beginning on or after the effective date of this section. An amended return does not qualify for this purpose, nor shall the provisions of §301.9100–1 of this chapter and any guidance promulgated thereunder.
apply. An election shall be made by the foreign corporation calculating its U.S. assets in accordance with the method elected. An elected method must be used for a minimum period of five years before the foreign corporation may elect a different method. To change an election before the end of the requisite five-year period, a foreign corporation must obtain the consent of the Commissioner or her delegate. The Commissioner or her delegate will generally consent to a foreign corporation's request to change its election only in rare and unusual circumstances. A foreign corporation that is a partner in more than one partnership is not required to elect to use the same method for each partnership interest.

(B) Elections with tiered partnerships. If a foreign corporation elects to use the asset method with respect to an interest in a partnership, and that partnership is a partner in a lower-tier partnership, the foreign corporation may apply either the asset method or the income method to determine the proportion of the upper-tier partnership's interest in the lower-tier partnership that is a U.S. asset.

(v) Failure to make proper election. If a foreign corporation, for any reason, fails to make an election to use one of the methods required by paragraph (d)(3) of this section in a timely fashion, the director of field operations or the Assistant Commissioner (International) may make the election on behalf of the foreign corporation and such election shall be binding as if made by that corporation.

(vi) Special rule for determining a partner's adjusted basis in a partnership interest. For purposes of paragraphs (d)(3) and (6) of this section, a partner's adjusted basis in a partnership interest shall be the partner's basis in such interest (determined under section 705) reduced by the partner's share of the liabilities of the partnership determined under section 752 and increased by a proportionate share of each liability of the partnership equal to the partner's proportionate share of the expense, for income tax purposes, attributable to such liability for the taxable year. A partner's adjusted basis in a partnership interest cannot be less than zero.

(vii) E&P basis of a partnership interest. See paragraph (d)(6)(iii) of this section for special rules governing the calculation of a foreign corporation's E&P basis in a partnership interest.

(viii) The application of this paragraph (d)(3) is illustrated by the following examples:

Example 1. General rule. (i) Facts. Foreign corporation, FC, is a partner in partnership ABC, which is engaged in a trade or business within the United States. FC and ABC are both calendar year taxpayers. ABC owns and manages two office buildings located in the United States, each with an adjusted basis of $50. ABC also owns a non-U.S. asset with an adjusted basis of $100. ABC has no liabilities. Under the partnership agreement, FC has a 50 percent interest in the capital of ABC and a 50 percent interest in all items of income, gain, loss, and deduction that may be generated by the partnership's assets. FC's adjusted basis in ABC is $100. In determining the proportion of its interest in ABC that is a U.S. asset, FC elects to use the asset method described in paragraph (d)(3)(ii) of this section.

(ii) Analysis. FC's interest in ABC is treated as a U.S. asset in the same proportion that the sum of FC's proportionate share of the adjusted bases of all ABC's U.S. assets (50% of $100), bears to the sum of FC's proportionate share of the adjusted bases of all of ABC's assets (50% of $200). Under the asset method, the amount of FC's interest in ABC that is a U.S. asset is $50 ($100/$200) × 50%.

Example 2. Special allocation of gain with respect to real property. (i) Facts. The facts are the same as in Example 1, except that under the partnership agreement, FC is allocated 20 percent of the income from the partnership property but 80 percent of the gain on disposition of the partnership property.

(ii) Analysis. Assuming that the buildings ordinarily generate directly identifiable income, there is a rebuttable presumption under paragraph (d)(3)(ii)(B)(1) of this section that FC's proportionate share of the adjusted basis of the buildings is FC's proportionate share of the income generated by the buildings (20%) rather than the total gain that it would be entitled to under the partnership agreement (80%) if the buildings were sold at a gain on the determination date. Thus, the sum of FC's proportionate share of the adjusted bases in ABC's U.S. assets (the buildings) is presumed to be $20 ([20% of $50] + [20% of $50]). Assuming that the non-U.S. asset is not income-producing and does not generate current deductions, there is a rebuttable presumption under paragraph (d)(3)(ii)(B)(3) of this section that FC's proportionate share of the adjusted basis of that asset is FC's interest in the gain on the disposition of the asset (80%).
rather than its proportionate share of the income that may be generated by the asset (20%). Thus, FC’s proportionate share of the adjusted basis of ABC’s non-U.S. asset is $100 (20% of $500). FC's proportionate share of the adjusted bases of all of the assets of ABC is $100 ($20 + $80). The amount of FC’s interest in ABC that is a U.S. asset is $20 ($100 × $100/$100).

Example 3. Tiered partnerships (asset method). (i) Facts. The facts are the same as in Example 1, except that FC’s adjusted basis in ABC is $175 and ABC also has a 50 percent interest in the capital of partnership DEF. DEF owns and operates a commercial shopping center in the United States with an adjusted basis of $200 and also owns non-U.S. assets with an adjusted basis of $100. DEF has no liabilities. ABC’s adjusted basis in its interest in DEF is $150 and ABC has a 50 percent interest in all the items of income, gain, loss and deduction that may be generated by the assets of DEF.

(ii) Analysis. Because FC has elected to use the asset method described in paragraph (d)(3)(i) of this section, it must determine what proportion of ABC’s partnership interest in DEF is a U.S. asset. As permitted by paragraph (d)(3)(iv)(B) of this section, FC also elects to use the asset method with respect to ABC’s interest in DEF. ABC’s interest in DEF is treated as a U.S. asset in the same proportion that the sum of ABC’s proportionate share of the adjusted bases of all of DEF’s U.S. assets (50% of $200), bears to the sum of ABC’s proportionate share of the adjusted bases of all of DEF’s assets (50% of $300). Thus, the amount of ABC’s interest in DEF that is a U.S. asset is $100 ($150 × $100/$150). FC must then apply the rules of paragraph (d)(3)(ii) of this section to all the assets of ABC, including ABC’s interest in DEF. Thus, the amount of FC’s interest in ABC that is a U.S. asset is $100 ($175 × $100/$175).

Example 4. Tiered partnerships (income method). (i) Facts. The facts are the same as in Example 3, except that FC has elected to use the income method described in paragraph (d)(3)(iii) of this section to determine the proportion of its interest in ABC that is a U.S. asset. The two office buildings located in the United States generate $60 of income that is ECI for the taxable year. The non-U.S. asset is not-income producing. In addition, ABC’s distributive share of income from DEF consists of $40 of income that is ECI and $140 of income that is not ECI.

(ii) Analysis. Because FC has elected to use the income method it does need to determine what proportion of ABC’s partnership interest in DEF is a U.S. asset. FC’s interest in ABC is treated as a U.S. asset in the same proportion that its distributive share of ABC’s income for the taxable year that is ECI ($50) ($30 earned directly by ABC + $20 distributive share from DEF) bears to its distributive share of all ABC’s income for the taxable year ($55) ($30 earned directly by ABC + $25 distributive share from DEF).

Thus, FC’s interest in ABC that is a U.S. asset is $159 ($175 × $50/$55).

(4) Interest in a trust or estate—(1) Estates and non-grantor trusts. A foreign corporation that is a beneficiary of a trust or estate shall not be treated as having a U.S. asset by virtue of its interest in the trust or estate.

(ii) Grantor trusts. If, under sections 671 through 678, a foreign corporation is treated as owning a portion of a trust that includes all the income and gain that may be generated by a trust asset (or pro rata portion of a trust asset), the foreign corporation will be treated as owning the trust asset (or pro rata portion thereof) for purposes of determining its U.S. assets under this section.

(5) Property that is not a U.S. asset—(1) Property that does not give rise to ECEP. Property described in paragraphs (d) (1) through (4) of this section shall not be treated as a U.S. asset of a foreign corporation if, on the determination date, income from the use of the property, or gain or loss from the disposition of the property, would be described in paragraph (f)(2) of this section (relating to certain income that does not produce ECEP).

(ii) Assets acquired to increase U.S. net equity artificially. U.S. assets shall not include assets acquired or used by a foreign corporation if one of the principal purposes of such acquisition or use is to increase artificially the U.S. assets of a foreign corporation on the determination date. Whether assets are acquired or used for such purpose will depend upon all the facts and circumstances of each case. Factors to be considered in determining whether one of the principal purposes in acquiring...
or using an asset is to increase artificially the U.S. assets of a foreign corporation include the length of time during which the asset was used in a U.S. trade or business, whether the asset was acquired from, or disposed of to, a related person, and whether the aggregate value of the U.S. assets of the foreign corporation increased temporarily on the determination date. For purposes of this paragraph (d)(5)(ii), to be one of the principal purposes, a purpose must be important, but it is not necessary that it be the primary purpose.

(iii) Interbranch transactions. A transaction of any type between separate offices or branches of the same taxpayer does not create a U.S. asset.

(6) E&P basis of a U.S. asset—(i) General rule. The E&P basis of a U.S. asset for purposes of this section is its adjusted basis for purposes of computing the foreign corporation’s earnings and profits. In determining the E&P basis of a U.S. asset, the adjusted basis of the asset (for purposes of computing taxable income) must be increased or decreased to take into account inclusions of income or gain, and deductions or similar charges, that affect the basis of the asset where such items are taken into account in a different manner for purposes of computing earnings and profits than for purposes of computing taxable income. For example, if section 312(k) requires that depreciation with respect to a U.S. asset be determined using the straight line method for purposes of computing earnings and profits, but depreciation with respect to the asset is determined using a different method for purposes of computing taxable income, the E&P basis of the property for purposes of this section must be computed using the straight line method of depreciation.

(ii) Installment obligations—(A) Sales in taxable year beginning on or after January 1, 1987. For purposes of this section, the E&P basis of an installment obligation described in paragraph (d)(2)(iii) of this section that arises in connection with an installment sale occurring in a taxable year beginning on or after January 1, 1987, shall equal zero.

(B) Sales in taxable year prior to January 1, 1987. For purposes of this section, the E&P basis of an installment obligation described in paragraph (d)(2)(iii) of this section that arises in connection with an installment sale occurring in a taxable year beginning before January 1, 1987, shall equal zero.

(iii) Computation of E&P basis in a partnership. For purposes of this section, a foreign corporation’s E&P basis in a partnership interest shall be the foreign corporation’s adjusted basis in such interest (as determined under paragraph (d)(3)(vi) of this section), further adjusted to take into account any differences between the foreign corporation’s distributive share of items of partnership income, gain, loss, and deduction for purposes of computing the taxable income of the foreign corporation and the foreign corporation’s distributive share of items of partnership income, gain, loss, and deductions for purposes of computing the earnings and profits of the foreign corporation.

(iv) Computation of E&P basis of a loss property. The E&P basis of a loss property (as defined in paragraph (d)(2)(ix) of this section) shall equal the E&P basis, immediately before the loss, of the U.S. asset with respect to which the loss was sustained, reduced (but not below zero) by—

(A) The amount of any deduction claimed under section 165 by the foreign corporation with respect to the loss for earnings and profits purposes; and

(B) Any compensation received with respect to the loss.

(v) Computation of E&P basis of financial instruments. [Reserved]

(vi) Example. The application of paragraph (d)(6)(ii) of this section is illustrated by the following example.
Example. Sale in taxable year beginning on or after January 1, 1987. Foreign corporation A, a calendar year taxpayer, sells a U.S. asset on the installment method in 1993. Under the terms of the sale, A is to receive $100, payable in ten annual installments of $10 beginning in 1994, plus an arm’s-length rate of interest on the unpaid balance of the sales price. A’s adjusted basis in the property sold is $70. The obligation received in connection with the installment sale is treated as a U.S. asset with an E&P basis of $100 ($30 (the amount of gain from the sale if the obligation were satisfied in full) + $70 (the adjusted basis of the property sold)). If A receives a payment of $10 (not including interest) in 1994 with respect to the obligation, the obligation is treated as a U.S. asset with an E&P basis of $90 ($100 – $10) as of the close of 1994.

(e) U.S. liabilities. The term U.S. liabilities means the amount of liabilities determined under paragraph (e)(1) of this section decreased by the amount of liabilities determined under paragraph (e)(3) of this section, and increased by the amount of liabilities determined under paragraph (e)(2) of this section.

(1) Liabilities based on §1.882–5. The amount of liabilities determined under this paragraph (e)(1) is the amount of U.S.-connected liabilities of the foreign corporation under §1.882–5 if the U.S.-connected liabilities were computed using the assets and liabilities of the foreign corporation as of the determination date (rather than the average of such assets and liabilities for the taxable year) and without regard to paragraph (e)(3) of this section.

(2) Additional liabilities—(i) Insurance reserves. The amount of liabilities determined under this paragraph (e)(2)(i) is the amount (as of the determination date) of the total insurance liabilities on United States business (within the meaning of section 842(b)(2)(B)) of a foreign corporation described in section 842(a) (relating to foreign corporations carrying on an insurance business in the United States) to the extent that such liabilities are not otherwise treated as U.S. liabilities by reason of paragraph (e)(1) of this section.

(ii) Liabilities described in §1.882–5(a)(1)(ii). The amount of liabilities determined under this paragraph (e)(2)(ii) is the amount (as of the determination date) of liabilities described in §1.882–5(a)(1)(ii) (relating to liabilities giving rise to interest expense that is directly allocated to income from a U.S. asset).

(3) Election to reduce liabilities—(1) General rule. The amount of liabilities determined under this paragraph (e)(3) is the amount by which a foreign corporation elects to reduce its liabilities under paragraph (e)(1) of this section.

(ii) Limitation. For any taxable year, a foreign corporation may elect to reduce the amount of its liabilities determined under paragraph (e)(1) of this section by an amount that does not exceed the lesser of the amount of U.S. liabilities as of the determination date, or the amount of U.S. liability reduction needed to reduce a dividend equivalent amount as of the determination date to zero.

(iii) Effect of election on interest deduction and branch-level interest tax. A foreign corporation that elects to reduce its liabilities under this paragraph (e)(3) must, for purposes of computing the amount of its interest apportioned to ECI under §1.882–5, reduce its U.S.-connected liabilities for the taxable year of the election by the amount of the reduction in liabilities under this paragraph (e)(3). The reduction of its U.S.-connected liabilities will also require a corresponding decrease in the amount of its interest apportioned to ECI under §1.882–5 for purposes of §1.884–4(a) and for all other Code sections for which the amount of interest apportioned under §1.882–5 is relevant.

(iv) Method of election. A foreign corporation that elects the benefits of this paragraph (e)(3) for a taxable year shall attach a statement to its return for the taxable year that it has elected to reduce its liabilities for the taxable year under this paragraph (e)(3) and that it has reduced the amount of its U.S.-connected liabilities as provided in paragraph (e)(3)(ii) of this section and shall indicate the amount of such reductions on such attachment. The cumulative amount of all U.S. liability reductions is shown on Schedule I (Form 1120–F) in addition to the separate elections attached to the timely filed return. An election under this paragraph (e)(3) must be made before the due date (including extensions) for the foreign corporation’s income tax return for the taxable year.
(v) Effect of election on complete termination. If a foreign corporation completely terminates its U.S. trade or business (within the meaning of §1.884-2T (a)(3)), notwithstanding §1.884-2T(a), the foreign corporation will be subject to tax on a dividend equivalent amount that equals the lesser of—

(A) The foreign corporation’s accumulated ECEP that is attributable to an election to reduce liabilities; or

(B) The amount by which the corporation elected to reduce liabilities at the end of the taxable year preceding the year of complete termination.

For purposes of the preceding sentence, accumulated ECEP is attributable to an election to reduce liabilities to the extent that the ECEP was accumulated because of such an election rather than because of an increase in U.S. assets. For example, if a foreign corporation did not have positive ECEP in any year for which an election was made, it would not be required to include an amount as a dividend equivalent amount under this paragraph (e)(3)(v) because any accumulated ECEP that it may have is not attributable to an election to reduce liabilities.

(4) Artificial decrease in U.S. liabilities. If a foreign corporation repays or otherwise decreases its U.S. liabilities and one of the principal purposes of such decrease is to decrease artificially its U.S. liabilities on the determination date, then such decrease shall not be taken into account for purposes of computing the foreign corporation’s U.S. net equity. Whether the U.S. liabilities of a foreign corporation are artificially decreased will depend on all the facts and circumstances of each case. Factors to be considered in determining whether one of the principal purposes for the repayment or decrease of the liabilities is to decrease artificially the U.S. liabilities of a foreign corporation shall include whether the aggregate liabilities are temporarily decreased on or before the determination date by, for example, the repayment of liabilities, or U.S. liabilities are temporarily decreased on or before the determination date by the acquisition with contributed funds of passive-type assets that are not U.S. assets. For purposes of this paragraph (e)(4), to be one of the principal purposes, a purpose must be important, but it is not necessary that it be the primary purpose.

(5) Examples. The application of this paragraph (e) is illustrated by the following examples.

Example 1. General rule for computation of U.S. liabilities. As of the close of 1997, foreign corporation A, a calendar year taxpayer computes its U.S.-connected liabilities under §1.882-5(c) using its actual ratio of liabilities to assets. For purposes of computing its U.S.-connected liabilities under §1.882-5(c), A must determine the average total value of its assets that are U.S. assets. Assume that the average value of such assets is $100, while the amount of such assets as of the close of 1997 is $125. For purposes of §1.882-5(c)(2), A must determine the ratio of the average of its worldwide liabilities for the year to the average total value of worldwide assets for the taxable year. Assume that A’s average liabilities-to-assets ratio under §1.882-5(c)(2) is 50 percent, while its liabilities-to-assets ratio at the close of 1997 is only 50 percent. Thus, assuming no further adjustments under paragraph (e)(3) of this section, A’s U.S.-connected liabilities for purposes of §1.882-5 are $55 ($100×50%). However, A’s U.S. liabilities are $62.50 for purposes of this section, the value of its assets determined under §1.882-5(b)(2) as of the close of December ($125) multiplied by the liabilities-to-assets ratio of (50%) as of such date.

Example 2. Election made to reduce liabilities. (i) As of the close of 2007, foreign corporation A, a real estate company, owns U.S. assets with an E&P basis of $1000. A has $800 of liabilities under paragraph (e)(1) of this section. A has accumulated ECEP of $500 and in 2008, A has $60 of ECEP that it intends to retain for future expansion of its U.S. trade or business. A elects under paragraph (e)(3) of this section to reduce its liabilities by $60 from $800 to $740. As a result of the election, assuming A’s U.S. assets and U.S. liabilities would otherwise have remained constant, A’s U.S. net equity as of the close of 2007 will increase by the amount of the decrease in liabilities ($60) from $300 to $240 and its ECEP will be reduced to zero. Under paragraph (e)(3)(ii) of this section, A’s interest expense for the taxable year is reduced by the amount of interest attributable to $60 of liabilities and A’s excess interest is reduced by the same amount. A’s taxable income and ECEP are increased by the amount of the reduction in interest expense attributable to the liabilities, and A may make an election under paragraph (e)(3) of this section to further reduce its liabilities, thus increasing its U.S. net equity and reducing the amount of additional ECEP created for the election.

(ii) In 2009, assuming A again has $60 of ECEP, A may again make the election under
paragraph (e)(3) to reduce its liabilities. However, assuming A's U.S. assets and liabilities under paragraph (e)(1) of this section remain constant, A will need to make an election to reduce its liabilities by $120 to reduce to zero its ECEP in 2009 and to continue to retain for expansion (without the payment of the branch profits tax) the $60 of ECEP earned in 2008. Without an election to reduce liabilities, A's dividend equivalent amount for 2009 would be $120 ($60 of ECEP plus the $60 reduction in U.S. net equity from $360 to $240). If A makes the election to reduce liabilities by $120 (from $360 to $240), A's U.S. net equity will increase by $60 (from $360 to $420) at the end of the previous year to $320), the amount necessary to reduce its ECEP to $0. However, the reduction of liabilities will itself create additional ECEP subject to section 884 because of the reduction in interest expense attributable to the $120 of liabilities. A can make the election to reduce liabilities by $120 without exceeding the limitation on the election provided in paragraph (e)(3)(ii) of this section because the $120 reduction does not exceed the amount needed to treat the 2009 and 2008 ECEP as reinvested in the net equity of the trade or business within the United States.

(iii) If A terminates its U.S. trade or business in 2009 in accordance with the rules in §1.884–2T(a). A would not be subject to the branch profits tax on the $60 of ECEP earned in that year. Under paragraph (e)(3)(v) of this section, however, it would be subject to the branch profits tax on the portion of the $60 of ECEP that it earned in 2008 that became accumulated ECEP because of an election to reduce liabilities.

(f) Effectively connected earnings and profits—(1) In general. Except as provided in paragraph (f)(2) of this section and as modified by §1.884–2T (relating to the incorporation or complete termination of a U.S. trade or business or the reorganization or liquidation of a foreign corporation or its domestic subsidiary), the term "effectively connected earnings and profits" ("ECEP") means the earnings and profits (or deficits therein) determined under section 312 and this paragraph (f) that are attributable to ECI (within the meaning of paragraph (d)(1)(iii) of this section). Because the term "ECI" includes income treated as effectively connected income that is ECI under section 842(b) (relating to minimum net investment income of an insurance business) or 864(c)(7) (relating to gain from property formerly held for use in a U.S. trade or business), ECEP also includes earnings and profits attributable to ECI of a foreign corporation earned through a partnership, and through a trust or estate. For purposes of section 884, gain on the sale of a U.S. real property interest by a foreign corporation that has made an election to be treated as a domestic corporation under section 887(1) will also give rise to ECEP. ECEP is not reduced by distributions made by the foreign corporation during any taxable year or by the amount of branch profits tax or tax on excess interest (as defined in §1.884–4(a)(2)) paid by the foreign corporation. Earnings and profits are treated as attributable to ECI even if the earnings and profits are taken into account under section 312 in an earlier or later taxable year than the taxable year in which the ECI is taken into account.

(2) Income that does not produce ECEP. The term "ECEP" does not include any earnings and profits attributable to—

(i) Income excluded from gross income under section 863(a)(1) or 863(a)(2) (relating to certain income derived from the operation of ships or aircraft);

(ii) Income that is ECI by reason of section 921(d) or 926(b) (relating to certain income of a FSC and certain dividends paid by a FSC to a foreign corporation or nonresident alien) that is not otherwise ECI;

(iii) Gain on the disposition of a U.S. real property interest described in section 897(c)(1)(A)(ii) (relating to certain interests in a domestic corporation);

(iv) Income that is ECI by reason of section 953(c)(3)(C) (relating to certain income of a captive insurance company that a corporation elects to treat as ECI) that is not otherwise ECI;

(v) Income that is exempt from tax under section 882 (relating to certain income of foreign governments); and

(vi) Income that is ECI by reason of section 882(e) (relating to certain interest income of banks organized under the laws of a possession of the United States) that is not otherwise ECI.

(3) Allocation of deductions attributable to income that does not produce ECEP. In determining the amount of a foreign corporation’s ECEP for the taxable year, deductions and other adjustments shall be allocated and apportioned under the principles of §1.861–8 between ECI that gives rise to ECEP and income described in paragraph (f)(2) of
this section (relating to income that is ECI but does not give rise to ECEP).

(4) Examples. The principles of paragraph (f) of this section are illustrated by the following examples.

Example 1. Tax-exempt income. Foreign corporation A owns a tax-exempt municipal bond that is a U.S. asset as of the close of its 1989 taxable year. The municipal bond gives rise in 1989 to ECI (even though the income is excluded from gross income under section 103(a) and is not gross income of a foreign corporation by reason of section 882(a), and therefore gives rise to ECEP in 1989.

Example 2. Income exempt under a treaty. Foreign corporation A derives ECI that constitutes business profits that are not attributable to a permanent establishment maintained by A in the United States. The ECI is exempt from taxation under section 882(a) by reason of an income tax treaty and section 894(a). The income nevertheless gives rise to ECEP under this paragraph (f). However, a dividend equivalent amount attributable to such ECEP may be exempt from the branch profits tax by reason of paragraph (g) of this section (relating to the application of the branch profits tax to corporations that are residents of countries with which the United States has an income tax treaty).

(g) Corporations resident in countries with which the United States has an income tax treaty—(1) General rule. Except as provided in paragraph (g)(2) of this section, a foreign corporation that is a resident of a country with which the United States has an income tax treaty in effect for a taxable year in which it has a dividend equivalent amount and that meets the requirements, if any, of the limitation on benefits provisions of such treaty with respect to the dividend equivalent amount shall not be subject to the branch profits tax on such amount (or will qualify for a reduction in the amount of tax with respect to such amount) only if—

(i) The foreign corporation is a qualified resident of such country for the taxable year, within the meaning of §1.884–5(a); or

(ii) The limitation on benefits provision, or an amendment to that provision, entered into force after December 31, 1986.

If, after application of §1.884–5(e)(4)(iv), a foreign corporation is a qualified resident under §1.884–5(e) (relating to the active trade or business test) only with respect to one of its trades or businesses in the United States, i.e., the trade or business that is an integral part of its business conducted in its country of residence, and not with respect to another, the rules of this paragraph shall apply only to that portion of its dividend equivalent amount attributable to the trade or business for which the foreign corporation is a qualified resident.

(2) Special rules for foreign corporations that are qualified residents on the basis of their ownership—(i) General rule. A foreign corporation that, in any taxable year, is a qualified resident of a country with which the United States has an income tax treaty in effect solely by reason of meeting the requirements of §1.884–5 (b) and (c) (relating, respectively, to stock ownership and base erosion) shall be exempt from the branch profits tax or subject to a reduced rate of branch profits tax under paragraph (g)(1) of this section with respect to the portion of its dividend equivalent amount for the taxable year attributable to accumulated ECEP only if the foreign corporation is a qualified resident of such country within the meaning of §1.884–5(a) for the taxable years includable, in whole or in part, in a consecutive 36-month period that includes the taxable year of the dividend equivalent amount. A foreign corporation that fails the 36-month test described in the preceding sentence shall be exempt from the branch profits tax or subject to the branch profits tax at a reduced rate under paragraph (g)(1) of this section with respect to accumulated ECEP (determined on a last-in-first-out basis) accumulated only during prior years in which the foreign corporation was a qualified resident of such country within the meaning of §1.884–5(a).

(ii) Rules of application. A foreign corporation that has not satisfied the 36-month test as of the close of the taxable year of the dividend equivalent amount but satisfies the test with respect to such dividend equivalent amount by meeting the 36-month test by the close of the second taxable year succeeding the taxable year of the dividend equivalent amount shall be subject to the branch profits tax for the year of the dividend equivalent amount without regard to paragraph (g)(1) of
this section on the portion of the dividend equivalent amount attributable to accumulated ECEP derived in a taxable year in which the foreign corporation was not a qualified resident within the meaning of §1.884-5(a). Upon meeting the 36-month test, the foreign corporation shall be entitled to claim by amended return a refund of the tax paid with respect to the dividend equivalent amount in excess of the branch profits tax calculated by taking into account paragraph (g)(2)(i) of this section, provided the foreign corporation establishes in the amended return for the taxable year that it has met the requirements of such paragraph. For purposes of section 6611 (dealing with interest on overpayments), any overpayment, any overpayment of branch profits tax by reason of this paragraph (g)(2)(ii) shall be deemed not to have been made before the filing date for the taxable year in which the foreign corporation establishes that it has met the 36-month test.

(iii) Example. The application of this paragraph (g)(2) is illustrated by the following example.

Example. (i) Foreign corporation A, a calendar year taxpayer, is a resident of the United Kingdom. A has a dividend equivalent amount for its taxable year 1991 of $300, of which $100 is attributable to 1991 ECEP and $200 to accumulated ECEP. A is a qualified resident for its taxable year 1991 because for that year it meets the requirements of §1.884-5 (b) and (c), relating, respectively, to stock ownership and base erosion. For 1991 A does not meet the requirements of §1.884-5 (d), (e), or (f) for qualified residence. A is not a qualified resident of the United Kingdom for any taxable year prior to 1990 but is a qualified resident for its taxable years 1990 and 1992.

(ii) Because A is a qualified resident for the 3-year period (1990, 1991, and 1992) that includes the taxable year of the dividend equivalent amount (1991), A satisfies the 36-month test of this paragraph (g)(2) and no branch profits tax is imposed on the total $300 dividend equivalent amount. However, since A was not a qualified resident for any taxable year prior to 1990 and therefore cannot establish that it has satisfied the 36-month test until the taxable year following the year of the dividend equivalent amount, A must pay the branch profits tax for its taxable year 1991 with respect to the portion of the dividend equivalent amount attributable to accumulated ECEP relating to years prior to 1990 without regard to paragraph (g)(1) of this section. A may file for a refund of the branch profits tax paid with respect to its 1991 taxable year at any time after it establishes that it is a qualified resident for its 1992 taxable year.

(3) Exemptions for foreign corporations resident in certain countries with income tax treaties in effect on January 1, 1987.

The branch profits tax shall not be imposed on the portion of the dividend equivalent amount with respect to which a foreign corporation satisfies the requirements of paragraphs (g) (1) and (2) of this section for a country listed below, so long as the income tax treaty between the United States and that country, as in effect on January 1, 1967, remains in effect, except to the extent the treaty is modified on or after January 1, 1987, to expressly provide for the imposition of the branch profits tax:

- Aruba
- Austria
- Belgium
- People’s Republic of China
- Cyprus
- Denmark
- Egypt
- Finland
- Germany
- Greece
- Hungary
- Iceland
- Ireland
- Italy
- United Kingdom
- Jamaica
- Japan
- Korea
- Luxembourg
- Malta
- Morocco
- Netherlands
- Netherlands Antilles
- Norway
- Pakistan
- Philippines
- Sweden
- Switzerland

(4) Modifications with respect to other income tax treaties—(i) Limitation on rate of tax—(A) General rule. If, under paragraphs (g) (1) and (2) of this section, a corporation qualifies for a reduction in the amount of the branch profits tax and paragraph (g)(3) of this section does not apply, the rate of tax shall be the rate of tax on branch profits specified in the treaty between the United States and the corporation’s country of residence or, if no rate of tax on branch profits is specified, the rate of tax that would apply under such treaty to dividends paid to the foreign corporation by a wholly-owned domestic corporation.

(B) Certain treaties in effect on January 1, 1987. The branch profits tax shall generally be imposed at the following rates on the portion of the dividend equivalent amount with respect to which a foreign corporation satisfies
the requirements of paragraphs (g)(1) and (2) of this section for a country listed below, for as long as the relevant provisions of those income tax treaties remain in effect and are not modified or superseded by subsequent agreement:

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>15%</td>
</tr>
<tr>
<td>Barbados</td>
<td>5%</td>
</tr>
<tr>
<td>Canada</td>
<td>10%</td>
</tr>
<tr>
<td>France</td>
<td>5%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>5%</td>
</tr>
<tr>
<td>Poland</td>
<td>5%</td>
</tr>
<tr>
<td>Romania</td>
<td>10%</td>
</tr>
<tr>
<td>South Africa</td>
<td>30%</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>5%</td>
</tr>
<tr>
<td>U.S.S.R.</td>
<td>30%</td>
</tr>
</tbody>
</table>

However, for special rates imposed on corporations resident in France and Trinidad & Tobago that have certain amounts of dividend and interest income, see the dividend articles of the income tax treaties with those countries.

(i) Limitations other than rate of tax. If, under paragraphs (g)(1) and (2) of this section, a foreign corporation qualifies for a reduction in the amount of branch profits tax and paragraph (g)(3) of this section does not apply, then—

(A) The foreign corporation shall be entitled to the benefit of any limitations on imposition of a tax on branch profits (in addition to any limitations on the rate of tax) contained in the treaty; and

(B) No branch profits tax shall be imposed with respect to a dividend equivalent amount out of ECEP or accumulated ECEP of the foreign corporation unless the ECEP or accumulated ECEP is attributable to a permanent establishment in the United States or, if not otherwise prohibited under the treaty, to gain from the disposition of a U.S. real property interest described in section 897(c)(1)(A)(i), except to the extent the treaty specifically permits the imposition of the branch profits tax on such earnings and profits.

No article in such treaty shall be construed to provide any limitations on imposition of the branch profits tax other than as provided in this paragraph (g)(4).

(iii) Computation of the dividend equivalent amount if a foreign corporation has both ECEP attributable to a permanent establishment and not attributable to a permanent establishment. To determine the dividend equivalent amount of a foreign corporation out of ECEP that is attributable to a permanent establishment, the foreign corporation may only take into account its U.S. assets, U.S. liabilities, U.S. net equity and ECEP attributable to its permanent establishment. Thus, a foreign corporation may not reduce the amount of its ECEP attributable to its permanent establishment by reinvesting all or a portion of that amount in U.S. assets not attributable to the permanent establishment.

(iv) Limitations under the Canadian treaty. The limitations on the imposition of the branch profits tax under the Canadian treaty include, but are not limited to, those described in paragraphs (g)(4)(iv) (A) and (B).

(A) Effect of deficits in earnings and profits. In the case of a foreign corporation that is a qualified resident of Canada, the dividend equivalent amount for any taxable year shall not exceed the foreign corporation’s accumulated ECEP as of the beginning of the taxable year plus the corporation’s ECEP for the taxable year. Thus, for example, if a foreign corporation that is a qualified resident of Canada has a deficit in accumulated ECEP of $200 as of the beginning of the taxable year and ECEP of $100 for the taxable year, it will have no dividend equivalent amount for the taxable year because it would have a cumulative deficit in ECEP of $100 as of the close of the taxable year. For purposes of this paragraph (g)(4)(iii)(A), any net deficit in accumulated earnings and profits attributable to taxable years beginning before January 1, 1987, shall be includible in determining accumulated ECEP.

(B) One-time exemption of Canadian $500,000—(1) General rule. In the case of a foreign corporation that is a qualified resident of Canada, the branch profits tax shall be imposed only with respect to that portion of the dividend equivalent amount for the taxable year that, when translated into Canadian dollars and added to the dividend equivalent amounts for preceding taxable years translated into Canadian dollars, exceeds Canadian $500,000. The value of the dividend equivalent amount in Canadian currency shall be determined by translating the ECEP for each taxable year that is includible in the dividend equivalent amount (as determined in
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U.S. dollars under the currency translation method used in determining the foreign corporation's taxable income for U.S. tax purposes) by the weighted average exchange rate for the taxable year (determined under the rules of section 988(b)(3)) during which the earnings and profits were derived.

(2) Reduction in amount of exemption in the case of related corporations. The amount of a foreign corporation’s exemption under this paragraph (g)(4)(iii)(B) shall be reduced by the amount of any exemption that reduced the dividend equivalent amount of an associated foreign corporation with respect to the same or a similar business. For purposes of this paragraph (g)(4)(iii)(B), a foreign corporation is an associated foreign corporation if it is related to the foreign corporation for purposes of section 267(b) or it and the foreign corporation are stapled entities (within the meaning of section 269B(c)(2)) or are effectively stapled entities. A business is the same as or similar to another business if it involves the same or a similar type of property or the provision of the same or a similar type of service. A U.S. real property interest described in section 897(c)(1)(A)(i) shall be treated as a business and all such U.S. real property interests shall be treated as businesses that are the same or similar.

(3) Coordination with second-tier withholding tax. The value of the dividend equivalent amount that is exempt from the branch profits tax by reason of paragraph (g)(4)(iii)(B)(1) of this section shall not be subject to tax under section 871(a) or 881, or to withholding under section 1441 or 1442, when distributed by the foreign corporation.

(5) Benefits under treaties other than income tax treaties. A treaty that is not an income tax treaty does not exempt a foreign corporation from the branch profits tax or reduce the amount of the tax.

(h) Stapled entities. Any foreign corporation that is treated as a domestic corporation by reason of section 269B (relating to stapled entities) shall continue to be treated as a foreign corporation for purposes of section 884 and the regulations thereunder; notwithstanding section 269B or the regulations thereunder. Dividends paid by such foreign corporation shall be treated as paid by a domestic corporation and shall be subject to the tax imposed by section 871(a) or 881(a), and to withholding under section 1441 or 1442, as applicable, to the extent paid out of earnings and profits that are not subject to tax under section 884(a). Dividends paid by such foreign corporation out of earnings and profits subject to tax under section 884(a) shall be exempt from the tax imposed by sections 871(a) and 881(a) and shall not be subject to withholding under section 1441 or 1442. Whether dividends are paid out of earnings and profits that are subject to tax under section 884(a) shall be determined under section 884(e)(3)(A) and the regulations thereunder. The limitation on the application of treaty benefits in section 884(e)(3)(B) (relating to qualified residents) shall apply to a foreign corporation described in this paragraph (h).

(i) Effective date—(1) General rule. This section is effective for taxable years beginning on or after October 13, 1992. With respect to a taxable year beginning before October 13, 1992 and after December 31, 1986, a foreign corporation may elect to apply this section in lieu of § 1.884–1T of the temporary regulations (as contained in the CFR edition revised as of April 1, 1992), but only if the foreign corporation also makes an election under § 1.884–4(e) to apply § 1.884.4 in lieu of § 1.884–4T (as contained in the CFR edition revised as of April 1, 1992) for that taxable year, and the statute of limitations for assessment of a deficiency has not expired for that taxable year. Once an election has been made, an election under this section shall apply to all subsequent taxable years. However, paragraph (f)(2)(vi) of this section (relating to certain interest income of Possessions banks) shall not apply for taxable years beginning before January 1, 1990.

(2) Election to reduce liabilities. A foreign corporation may make an election to reduce its liabilities under paragraph (e)(3) of this section with respect to a taxable year for which an election under paragraph (j)(1) of this section is in effect by filing an amended return for the taxable year and recomputing

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its interest deduction and any other item affected by the election on an amended Form 1120F to take into account the reduction in liabilities for such year.

(3) Separate election for installment obligations. A foreign corporation may make a separate election to apply paragraphs (d)(2)(iii) and (d)(6)(ii) of this section (relating to installment obligations treated as U.S. assets) to any prior taxable year without making an election under paragraph (i)(1) of this section, provided the statute of limitations for assessment of a deficiency has not expired for that taxable year and each succeeding taxable year. Once an election under this paragraph (i)(3) has been made, it shall apply to all subsequent taxable years.

(4) Special rules for certain U.S. assets and liabilities. Paragraphs (c)(2) (i) and (ii), (d)(3), (d)(4), (d)(5)(ii), (d)(6)(iii), (d)(6)(vi), (e)(2), and (e)(3)(ii), of this section are effective for taxable years beginning on or after June 6, 1996.

(j) Transition rules—(1) General rule. Except as provided in paragraph (j)(2) of this section, in order to compute its dividend equivalent amount in the first taxable year to which this section applies (whether or not such year begins before October 13, 1992), a foreign corporation must recompute its U.S. net equity as of close of the preceding taxable year using the rules of this section and use such recomputed amount, rather than the amount computed under § 1.884–1T (as contained in the CFR edition revised as of April 1, 1992), to determine the amount of any increase or decrease in the U.S. net equity as of the close of that taxable year.

(2) Installment obligations—(i) Interest election. In recomputing its U.S. net equity as of the close of the preceding taxable year, a foreign corporation that holds an installment obligation treated as a U.S. asset under § 1.884–1T(d)(7) (as contained in the CFR edition revised as of April 1, 1992) as of such date may apply the rules of paragraph (d)(2)(iii) of this section without regard to the rule in that paragraph that requires interest or original issue discount on the obligation to be treated as ECI in order for such obligation to be treated as a U.S. asset.

(ii) 1987 sales by certain foreign corporations. The E&P basis of an installment obligation arising in connection with a sale of property by a foreign corporation described in section 312(k)(4), where such sale occurs in a taxable year beginning in 1987, shall equal the E&P basis of the property sold as of the determination date reduced by payments received with respect to the obligation that do not represent gain for earnings and profits purposes, interest or original issue discount.


§ 1.884–2 Special rules for termination or incorporation of a U.S. trade or business or liquidation or reorganization of a foreign corporation or its domestic subsidiary.

(a) through (a)(2)(i) [Reserved]. For further information, see § 1.884–2T(a) through (a)(2)(i).

(a)(2)(ii) Waiver of period of limitations. The waiver referred to in § 1.884–2T(a)(2)(i)(D) shall be executed on Form 8848, or substitute form, and shall extend the period for assessment of the branch profits tax for the year of complete termination to a date not earlier than the close of the sixth taxable year following that taxable year. This form shall include such information as is required by the form and accompanying instructions. The waiver must be signed by the person authorized to sign the income tax returns for the foreign corporation (including an agent authorized to do so under a general or specific power of attorney). The waiver must be filed on or before the date (including extensions) prescribed for filing the foreign corporation’s income tax return for the year of complete termination. With respect to a complete termination occurring in a taxable year ending prior to June 6, 1996 a foreign corporation may also satisfy the requirements of this paragraph (a)(2)(ii) by applying § 1.884–2T(a)(2)(ii) of the temporary regulations (as contained in the CFR edition revised as of April 1, 1995). A properly executed