the interest paid from C to B would result in 25u of interest income to B and 25u of deductible interest expense to C. For purposes of reporting the combined income of B and C, country X first requires B and C to determine their own income (or loss) on a separate basis. For this purpose, however, neither B nor C takes into account the 25u of interest paid from C to B because the income of B and C is included in the same combined base. The separate income of B and C reported on their country X schedules for year 1, which do not reflect the 25u intercompany payment, is 100u and 200u, respectively. The combined income reported for country X purposes is 300u (the sum of the 100u separate income of B and 200u separate income of C).

(ii) Result. On the separate schedules described in paragraph (f)(3)(i)(A) of this section, B’s separate income is 100u and C’s separate income is 200u. Under paragraph (f)(3)(i)(B)(I) of this section, the 25u interest payment from C to B is taken into account for purposes of determining B’s and C’s portions of the combined income under paragraph (f)(3)(i) of this section, because B and C would have taken the items into account if they did not compute their income on a combined basis. Thus, B’s portion of the combined income is 125u (100u plus 25u) and C’s portion of the combined income is 175u (200u less 25u). The result is the same regardless of whether the 25u interest payment from C to B is deductible for U.S. Federal income tax purposes. See paragraph (f)(3)(i)(B)(2) of this section.

Example 2. (i) Facts. A, a U.S. person, owns 100 percent of B, an entity organized in country X. B is a corporation for country X tax purposes, and a disregarded entity for U.S. income tax purposes. B owns 100 percent of C and D, entities organized in country X that are corporations for both U.S. and country X tax purposes. B, C, and D use the “u” as their functional currency and file on a combined basis for country X income tax purposes. Country X imposes an income tax described in paragraph (a)(1) of this section at a rate of 30 percent on the taxable income of D. On September 30 of Year 1, A sells its 50 percent interest in D to C. A’s sale of its partnership interest results in a termination of the partnership under section 708(b)(1)(B) for U.S. tax purposes. As a result of the termination, “old” D’s taxable year closes on September 30 of Year 1 for U.S. tax purposes. New D also has a short U.S. taxable year, beginning on October 1 and ending on December 31 of Year 1. The sale of A’s interest does not close D’s taxable year for country X tax purposes. D has 400u of taxable income for its foreign taxable year ending December 31, Year 1 with respect to which country X imposes 120u of income tax, equal to $120 as translated in accordance with section 970.1(a).

(ii) Result. Under paragraph (f)(4)(i) of this section, partnership D is legally liable for the $120 of country X income tax imposed on its foreign taxable income. Because D’s taxable year closes on September 30, Year 1, for U.S. tax purposes, but does not close for country X tax purposes, under paragraph (f)(4)(i) of this section the $120 of country X tax must be allocated among A, B, and C. Under law of country X, D is considered to have legal liability for tax, even if the tax is paid or accrued on a date that falls within a taxable year of such other person beginning after February 14, 2012. Taxpayers may choose to apply paragraph (f)(3) of this section to foreign taxes paid or accrued in taxable years beginning after December 31, 2010, and on or before February 14, 2012.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved: February 8, 2012.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CF R Part 1

[TD 9577]

RIN 1545–BK50

Foreign Tax Credit Splitting Events

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary Income Tax Regulations with respect to a new provision of the Internal Revenue Code (Code) that addresses situations in which foreign income taxes have been separated from the related income. These regulations are necessary to provide guidance on applying the new statutory provision, which was enacted as part of legislation commonly referred to as the Education Jobs and Medicaid Assistance Act (EJMAA) on August 10, 2010. These regulations affect taxpayers claiming foreign tax credits. The text of the temporary regulations also serves as the text of the proposed regulations (REG–132736–11) published in the Proposed Rules section of this issue of the Federal Register.

DATES: Effective Date: These regulations are effective on February 14, 2012.

Applicability Dates: For dates of applicability, see §§ 1.704–1T(b)(1)(iii)(B)(9), 1.909–1T(e), 1.909–27(c), 1.909–37(c), 1.909–47(b), 1.909–57(c), and 1.909–67(b).

FOR FURTHER INFORMATION CONTACT: Suzanne M. Walsh, (202) 622–3850 (not a toll-free call).
SUPPLEMENTARY INFORMATION:

Background

I. Section 909

Section 909 was enacted as part of EJMAA (Pub. L. 111–226, 124 Stat. 2389 (2010)) to address situations in which foreign income taxes have been separated from the related income. Section 909(a) provides that if there is a foreign tax credit splitting event with respect to a foreign income tax paid or accrued by a taxpayer, such tax is not taken into account for federal tax purposes before the taxable year in which the related income is taken into account by the taxpayer. Section 909(b) provides special rules with respect to a “section 902 corporation,” which is defined in section 909(d)(5) as any foreign corporation with respect to which one or more domestic corporations meets the ownership requirements of section 902(a) or (b) (a section 902 shareholder of the relevant section 902 corporation). If there is a foreign tax credit splitting event with respect to a foreign income tax paid or accrued by a section 902 corporation, the tax is not taken into account for purposes of section 902 or 960, or for purposes of determining earnings and profits under section 964(a), before the taxable year in which the related income is taken into account by such section 902 corporation or a section 902 shareholder. Thus, the tax is not added to the section 902 corporation’s pool of “post-1986 foreign income taxes” (as defined in section 902(c)(2) and § 1.902–1(a)(8)), and its pool of “post-1986 undistributed earnings” (as defined in section 902(c)(1) and § 1.902–1(a)(9)) is not reduced by such tax. Accordingly, section 909 suspends foreign income taxes paid or accrued by a section 902 corporation at the level of the payor section 902 corporation. In the case of a partnership, section 909(a) and (b) apply at the partner level, and, except as otherwise provided by the Secretary, a similar rule applies in the case of an S corporation or trust. See section 909(c)(1).

For purposes of section 909, there is a foreign tax credit splitting event with respect to a foreign income tax if the related income is (or will be) taken into account by a covered person. See section 909(d)(1). Section 909 does not suspend foreign income taxes if the same person pays the tax but takes into account the related income in a different taxable period (or periods) due to, for example, timing differences between the U.S. and foreign tax accounting rules. The term “foreign income tax” means any income, war profits, or excess profits tax paid or accrued to any foreign country or to any possession of the United States. See section 909(d)(2). The Joint Committee on Taxation’s technical explanation of the revenue provisions of EJMAA states that a foreign income tax includes any tax paid in lieu of such a tax within the meaning of section 903. Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 1586, Scheduled For Consideration by the House of Representatives on August 10, 2010, at 5 (August 10, 2010) (JCT Explanation).

Section 909(d)(3) provides that the term “related income” means, with respect to any portion of any foreign income tax, the income (or, as appropriate, earnings and profits) to which such portion of the foreign income tax relates. The term “covered person” means, with respect to any person who pays or accrues a foreign income tax (the “payor”): (1) Any entity in which the payor holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value); (2) any person that holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value) in the payor; (3) any person that bears a relationship to the payor described in section 267(b) or 707(b); and (4) any other person specified by the Secretary. See section 909(d)(4).

Except as otherwise provided by the Secretary, any foreign income tax not currently taken into account by reason of section 909 is taken into account as a foreign income tax paid or accrued in the taxable year in which, and to the extent that, the taxpayer, the section 902 corporation or a section 902 shareholder (as the case may be) takes the related income into account under chapter 1 of Subtitle A of the Code. See section 909(c)(2).

Notwithstanding this general rule, foreign income taxes are translated into U.S. dollars under the rules of section 986(a) in the year actually paid or accrued and suspended, and not as if any pre-2011 taxes to which section 909 applies that were previously deducted in computing earnings and profits in a pre-2011 taxable year. The JCT Explanation clarifies that the section 909 effective date rule “applies for purposes of applying sections 902 and 960 to dividends paid, and inclusions under section 951(a) that occur, in taxable years beginning after December 31, 2010.” JCT Explanation at 6–7.

II. Section 901 Proposed Regulations

Section 909 was enacted to address concerns about the inappropriate separation of foreign income taxes and related income. These concerns were also the basis for the issuance in 2006 of proposed regulations under section 901 (2006 proposed regulations) concerning the determination of the person who paid a foreign income tax for foreign tax credit purposes (REG–124152–06, 71 FR 44240 (Aug. 4, 2006)).

In particular, the proposed regulations would provide guidance under § 1.901–2(f) relating to the person on whom foreign law imposes legal liability for tax, including in the case of taxes imposed on the income of foreign consolidated groups and entities that have different classifications for U.S. and foreign tax law purposes. The Treasury Department and the IRS received written comments on the proposed regulations and held a hearing on October 13, 2006. All comments are available at www.regulations.gov or upon request. After taking into account the comments received, the 2006 proposed regulations are adopted, in part, as final regulations published elsewhere in this issue of the Federal Register.

III. Notice 2010–92

The Treasury Department and the IRS issued Notice 2010–92 (2010–2 CB 916 (December 6, 2010)), which primarily
addresses the application of section 909 to foreign income taxes paid or accrued by a section 902 corporation in pre-2011 taxable years. The notice provides rules for determining whether foreign income taxes paid or accrued by a section 902 corporation in pre-2011 taxable years (pre-2011 taxes) are suspended under section 909 in post-2010 taxable years of a section 902 corporation. It also identifies an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events in pre-2011 taxable years (pre-2011 splitter arrangements) and provides guidance on determining the amount of related income and pre-2011 taxes paid or accrued with respect to pre-2011 splitter arrangements. The pre-2011 splitter arrangements are reverse hybrid structures, certain foreign consolidated groups, disregarded debt structures in the context of group relief and other loss-sharing regimes, and two classes of hybrid instruments. The notice states that the Treasury Department and the IRS expect future guidance will treat pre-2011 splitter arrangements as giving rise to foreign tax credit splitting events in post-2010 taxable years.

Notice 2010–92 states that future guidance may identify additional transactions or arrangements to which section 909 applies (including, for example, additional arrangements involving group relief regimes), although any such guidance will apply only with respect to foreign taxes paid or accrued in post-2010 taxable years. The notice also states that the Treasury Department and the IRS do not intend to finalize the portion of the 2006 proposed regulations relating to the determination of the person who paid a foreign income tax with respect to the income of a reverse hybrid. See Prop. § 1.901–2(f)(2)(iii).

Concerning the effective date of section 909(b) (addressing a foreign tax credit splitting event with respect to a foreign income tax paid or accrued by a section 902 corporation), Notice 2010–92 provides that, consistent with the JCT Explanation, the Treasury Department and the IRS intend to issue regulations providing that section 909 does not apply in computing foreign taxes deemed paid under section 902 or 960 before the first day of the section 902 corporation’s first post-2010 taxable year. Regarding the application of the section 909 effective date to situations involving partnerships, the notice states that in the case of a section 902 corporation that is a partner in a partnership, the section 902 corporation’s distributive share of foreign income taxes paid or accrued by the partnership in a pre-2011 taxable year of the partnership that is included in a post-2010 taxable year of the section 902 corporation will be treated as a tax paid or accrued by the section 902 corporation in a post-2010 taxable year. See § 1.702–1(a)(6).

Notice 2010–92 also provides guidance concerning the application of section 909 to partnerships and trusts, as well as the interaction between section 909 and other Code provisions. In addition, the notice solicits comments on issues that should be addressed in regulations, including whether portions of the 2006 proposed regulations should be finalized or modified in light of the enactment of section 909. The Treasury Department and the IRS received written comments on Notice 2010–92, which are discussed in this preamble.

Explanation of Provisions

I. Section 704(b)

Section 1.704–1(b)(4)(viii)(d)(3) provides that if a branch of a partnership (including a disregarded entity owned by the partnership) is required to include in income under foreign law a payment (an inter-branch payment) it receives from the partnership or another branch of the partnership, any creditable foreign tax expenditure (CFTE) imposed with respect to the payment relates to the income in the CFTE category that includes the items attributable to the recipient (the recipient CFTE category). However, because the inter-branch payment is disregarded for U.S. Federal income tax purposes, the income related to the CFTEs imposed with respect to the payment may remain in the CFTE category that includes the items attributable to the payor of the inter-branch payment (the payor CFTE category). This is an exception to the general principles of § 1.904–6. The Treasury Department and the IRS have determined that the regulations should be revised to prevent allocations under § 1.704–1(b)(4)(viii)(d)(3) that would result in such a separation of taxation and related income from satisfying the safe harbor, regardless of whether section 909 applies.

These temporary regulations remove the special exception for inter-branch payments set forth in § 1.704–1(b)(4)(viii)(d)(3). As a result, the general principles of § 1.904–6 will apply to an inter-branch payment so that the CFTEs imposed on that payment will be allocated to the CFTE category that includes the related income for U.S. Federal income tax purposes. Accordingly, if the CFTEs and related income are allocated to partners in the same ratios, the safe harbor is satisfied and the allocation does not give rise to a foreign tax credit splitting event. The temporary regulations revise Example 24 of § 1.704–1(b)(5) to reflect these changes. These changes are generally effective for taxable years beginning on or after January 1, 2012. Allocations made in accordance with § 1.704–1(b)(4)(viii)(d)(3) in taxable years beginning on or after January 1, 2011, and before January 1, 2012, will result in a foreign tax credit splitting event and suspension of foreign income taxes that are allocated to a different partner than the covered person that is allocated the related income. See § 1.909–5T(a)(2).
The temporary regulations also provide a transition rule for partnerships whose agreements were entered into prior to February 14, 2012. If there has been no material modification to the partnership agreement on or after February 14, 2012, then the partnership may apply the provisions of § 1.704–1(b)(4)(vi)(i)(j) and § 1.704–1(b)(4)(vi)(d)(3) as in effect prior to February 14, 2012. See § 1.704–1T(b)(1)(ii)(b)(3). For purposes of this transition rule, any change in ownership constitutes a material modification to the partnership agreement. This transition rule does not apply to any taxable year in which persons bearing a relationship to each other specified in section 267(b) or 707(b) collectively have the power to amend the partnership agreement without the consent of any unrelated party (and all subsequent taxable years). In the case of any partnership that applies, under the transition rule, the provisions of § 1.704–1(b)(4)(vi)(c)(3)(i) and § 1.704–1(b)(4)(vi)(d)(3) as in effect prior to February 14, 2012, an allocation of foreign income taxes paid or accrued by the partnership with respect to an inter-branch payment will result in a foreign tax credit splitting event to the extent that the tax on the inter-branch payment is not allocated to the partners in proportion to the distributive shares of income to which the inter-branch payment tax relates. See § 1.909–2T(b)(4).

II. Section 909

A. In General

The temporary regulations provide an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events under section 909 with respect to foreign income taxes paid or accrued in taxable years beginning on or after January 1, 2012, as well as an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events with respect to foreign income taxes paid or accrued in a taxable year beginning on or after January 1, 2011, and before January 1, 2012. The temporary regulations further treat the foreign consolidated group splitter arrangement described in § 1.909–6T(b)(2) as giving rise to a foreign tax credit splitting event with respect to foreign income taxes paid or accrued in a taxable year beginning on or after January 1, 2012, and on or before February 14, 2012. In addition, these regulations provide rules for determining related income and split taxes and for coordinating the interaction between section 909 and other Code provisions. Finally, these regulations include the guidance described in Notice 2010–92, which primarily addresses the application of section 909 to foreign income taxes paid or accrued by section 902 corporations in taxable years beginning on or before December 31, 2010.

B. Definitions and Special Rules

Section 1.909–1T(a) provides definitions, and § 1.909–1T(b), (c), and (d) provide rules that apply for purposes of that section and §§ 1.909–2T through 1.909–5T. First, § 1.909–1T(b) and (c) provide rules substantially similar to those set forth in Notice 2010–92 concerning the application of section 909 to partnerships and trusts, except that the temporary regulations expand the scope of the rules to include S corporations and taxes paid or accrued by persons other than section 902 corporations. Section 1.909–1T(d) provides that under section 909(c)(1), section 909 applies at the partner level, and similar rules apply in the case of an S corporation or trust. Accordingly, in the case of foreign income taxes paid or accrued by a partnership, S corporation or trust, taxes allocated to one or more partners, shareholders or beneficiaries (as the case may be) will be treated as split taxes to the extent such taxes would be split taxes if the partner, shareholder or beneficiary had paid or accrued the taxes directly on the date such taxes are taken into account by the partner under sections 702 and 706(a), by the shareholder under section 1373(a), or by the beneficiary under section 901(b)(5). Any such split taxes will be suspended in the hands of the partner, shareholder or beneficiary.

Section 5.02 of Notice 2010–92 provides that, for purposes of applying section 909 in post-2010 taxable years, there will not be a foreign tax credit splitting event with respect to a foreign income tax paid or accrued by a partner with respect to its allocable share of the related income of a partnership that is a covered person with respect to the partner to the extent the related income is taken into account by the partner. A comment recommended that regulations adopt an aggregate approach in the partnership context in determining whether related income is taken into account by a covered person. The Treasury Department and the IRS believe that a transaction or arrangement in which the related income was taken into account by a covered person before the associated foreign income tax is paid or accrued (for example, due to a timing difference) presents the same concerns about the inappropriate separation of foreign income taxes and related income that section 909 was intended to address. Accordingly, § 1.909–2T(a)(1) provides that there is a foreign tax credit splitting event with respect to foreign income taxes paid or accrued if and only if, in connection with an arrangement described in § 1.909–2T(b) (a splitter arrangement) the related income was, is or will be taken into account by a covered person that is a covered person with respect to the payor of the tax.

Foreign income taxes that are paid or accrued in connection with a splitter arrangement are split taxes to the extent provided in § 1.909–2T(b). Income (or,
as the case may be, earnings and profits) that was, is or will be taken into account by a covered person in connection with a splitter arrangement is related income to the extent provided in § 1.909–2T(b). Split taxes will not be taken into account for U.S. Federal income tax purposes before the taxable year in which the related income is taken into account by the payor or, in the case of split taxes paid or accrued by a section 902 corporation, by a section 902 shareholder of such section 902 corporation. Therefore, in the case of split taxes paid or accrued by a section 902 corporation, split taxes will not be taken into account for purposes of section 902 or 960, or for purposes of determining earnings and profits under section 964(a), before the taxable year in which the related income is taken into account by the payor section 902 corporation, a section 902 shareholder of the section 902 corporation, or a member of the section 902 shareholder’s consolidated group. See § 1.909–3T(a) for rules relating to when split taxes and related income are taken into account.

A comment requested that the regulations provide an exclusive list of arrangements that are subject to section 909 for post-2010 taxable years, similar to the approach adopted in Notice 2010–92, which provides an exclusive list of arrangements that are treated as giving rise to foreign tax credit splitting events for purposes of applying section 909 to pre-2011 taxes paid or accrued by section 902 corporations. The Treasury Department and the IRS agree with the comment and accordingly, § 1.909–2T(b) sets forth an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events. Future guidance may identify additional transactions or arrangements to which section 909 applies, although any such guidance will apply to foreign taxes paid or accrued in taxable years beginning on or after the date such guidance is issued.

In particular, the Treasury Department and the IRS are concerned about certain types of asset transfers that can result in the separation of foreign income taxes and the related income, for example, because of differences in when income accrues or how basis is determined for purposes of U.S. and foreign tax law. Section 901(m) applies to foreign taxes paid or accrued in connection with certain transactions that are covered asset acquisitions described in section 901(m)(2). The Treasury Department and the IRS considered several approaches to address the interaction of sections 901(m) and 909, including providing taxpayers with an election to apply section 909 in lieu of section 901(m). The Treasury Department and the IRS concluded that applying section 909 to covered asset acquisitions between related parties would substantially increase the complexity and administrative burdens associated with such transactions. Accordingly, a covered asset acquisition is not a foreign tax credit splitting event for purposes of section 909. Nevertheless, section 901(m) may apply to foreign taxes paid or accrued in connection with a foreign tax credit splitting event, for example, if an election under section 338(a) is made with respect to the acquisition of the interests in a reverse hybrid. In such case, the Treasury Department and the IRS are considering the extent to which section 909 should apply to suspend deductions for foreign income taxes with respect to which section 901(m) disallows a credit.

The Treasury Department and the IRS are also considering whether to treat as foreign tax credit splitting events other arrangements or transactions that can result in the separation of foreign income taxes and the related income, for example, because of differences in when a shareholder is taxed on a dividend out of earnings of a covered person. One such arrangement is a distribution that is a dividend for foreign tax purposes but for U.S. Federal income tax purposes is either not includible in the shareholder’s gross income pursuant to section 305(a) or is disregarded. See Rev. Rul. 80–154 (1980–1 CB 68) (involving a series of arrangements that were treated as a stock distribution from a foreign corporation to which section 305(a) applies), and Rev. Rul. 83–142 (1983–2 CB 68) (involving a cash payment by a corporation to its shareholder which was returned to the corporation and disregarded for U.S. Federal income tax purposes even though treated as a dividend subject to withholding tax under foreign law). The Treasury Department and the IRS are considering whether and to what extent such types of asset transfers and distributions should be treated as foreign tax credit splitting events and request comments on the circumstances in which such treatment should apply.

2. Reverse Hybrid Splitter Arrangements

Section 1.909–2T(b)(1) describes a reverse hybrid splitter arrangement. The definition of a reverse hybrid splitter arrangement is substantially identical to that set forth in Notice 2010–92, except that the scope is extended to cover taxes paid or accrued by persons other than section 902 corporations. A reverse hybrid is an entity that is a corporation for U.S. Federal income tax purposes but is a fiscally transparent entity (under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity. A reverse hybrid is a splitter arrangement when a payor pays or accrues foreign income taxes with respect to income of a reverse hybrid. A reverse hybrid splitter arrangement exists even if the reverse hybrid has a loss or a deficit in earnings and profits for a particular year for U.S. Federal income tax purposes (for example, due to a timing difference). The foreign income taxes paid or accrued with respect to income of the reverse hybrid are split taxes. The related income with respect to split taxes from a reverse hybrid splitter arrangement is the earnings and profits (computed for U.S. Federal income tax purposes) of the reverse hybrid attributable to the activities of the reverse hybrid that gave rise to income included in the payor’s foreign tax base with respect to which the split taxes were paid or accrued. Accordingly, related income of the reverse hybrid only includes items of income or expense attributable to a disregarded entity owned by the reverse hybrid to the extent that the income attributable to the activities of the disregarded entity is included in the payor’s foreign tax base.

3. Loss-Sharing Splitter Arrangements

Section 1.909–2T(b)(2) expands the types of loss-sharing arrangements that Notice 2010–92 treats as splitter arrangements. A foreign group relief or loss-sharing regime is a regime in which one entity may surrender its loss to offset the income of one or more other entities. Such a loss of one entity that, in connection with a foreign group relief or other loss-sharing regime, is taken into account by one or more other entities for foreign tax purposes is a “shared loss.” Shared losses can be used to shift foreign tax liability from one entity to another without a concomitant shift in U.S. earnings and profits. Notice 2010–92 applied only to shared losses attributable to debt that is disregarded for U.S. Federal income tax purposes. A comment suggested that it would be appropriate to treat other loss-sharing arrangements as foreign tax credit splitter arrangements as well, in particular, when the payor of a tax could have used the shared loss to offset foreign tax on income that is treated as the payor’s own income under U.S. Federal income tax principles. The Treasury Department and the IRS agree that the scope of loss-sharing arrangements that are treated as splitter arrangements should be expanded to cover these cases. Accordingly § 1.909–
2T(b)(2)(i) defines a “loss-sharing splitter arrangement” as arising under a foreign group relief or other loss-sharing regime to the extent a shared loss of a U.S. combined income group could have been used to offset income of that group (a “usable shared loss”) but is used instead to offset income of another U.S. combined income group.

Under § 1.909–2T(b)(2)(ii), a U.S. combined income group consists of a single individual or corporation and all other entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of § 1.894–1(d)(3)) that for U.S. Federal income tax purposes combine any of their respective items of income, deduction, gain or loss with the income, deduction, gain or loss of such individual or corporation. A U.S. combined income group may arise, for example, as a result of an entity being disregarded for U.S. Federal income tax purposes or, in the case of a partnership or hybrid partnership and a partner, as a result of the allocation of income or any other item of the partnership to the partner. For this purpose, a branch is treated as an entity, all members of a U.S. consolidated group are treated as a single corporation, and individuals filing a joint return are treated as a single individual. A U.S. combined income group may consist of a single individual or corporation and no other entities, but cannot include more than one individual or corporation. In addition, an entity that combines items of income, deduction, gain or loss with the income, deduction, gain or loss of two or more other entities can belong to more than one U.S. combined income group. For example, a hybrid partnership that has two corporate partners that do not combine items of income, deduction, gain or loss with the income, deduction, gain or loss of each other belongs to each partner’s separate U.S. combined income group, because each partner receives an allocable share of hybrid partnership items.

Under § 1.909–2T(b)(2)(iii)(A), the income of a U.S. combined group consists of the aggregate amount of taxable income of the members of the group that have positive taxable income, as computed under foreign law. Under § 1.909–2T(b)(2)(iii)(B), the amount of shared loss of a U.S. combined income group is the sum of the shared losses of all members of the group. Section 1.909–2T(b)(2)(iii)(A) and (B) provide that in the case of an entity that is fiscally transparent (under the principles of § 1.894–1(d)(3)) for foreign tax purposes and that is a member of more than one U.S. combined income group, the foreign taxable income or shared loss of the entity is allocated between or among the groups under foreign tax law. In the case of an entity that is not fiscally transparent for foreign tax purposes and is a member of more than one U.S. combined income group, the entity’s foreign taxable income or shared loss is allocated between the separate U.S. combined income groups based on U.S. Federal income tax principles. Although the allocations are based on U.S. Federal income tax principles, the amount of the foreign taxable income or shared loss to be allocated is determined under foreign law. In the case of a hybrid partnership with two partners that are in different U.S. combined income groups, income or a shared loss incurred by the hybrid partnership, as determined under foreign law, is allocated between or among the U.S. combined income groups based on how the hybrid partnership would allocate the income or shared loss if it were recognized for U.S. tax purposes in the year it is recognized for foreign tax purposes. To the extent the income or shared loss would not constitute income or loss under U.S. tax principles in any year, the income or shared loss is allocated to the U.S. combined income groups based on how the hybrid partnership would allocate the income or shared loss if it were recognized for U.S. tax purposes. To the extent the income or shared loss is allocated to a U.S. combined income group, the attributable income or loss with respect to income equal to the amount of the usable shared loss of that U.S. combined income group that offsets income of a different U.S. combined income group. Under § 1.909–2T(b)(2)(v), the related income is an amount of income of the individual or corporate partner of a U.S. combined income group equal to the amount of income of that U.S. combined income group that is offset by the usable shared loss of another U.S. combined income group.

4. Hybrid Instrument Splitter Arrangements

Section 1.909–2T(b)(3) describes hybrid instrument splitter arrangements. The definition of hybrid instrument splitter arrangements is substantially identical to that set forth in Notice 2010–92, except that the scope is extended to cover taxes paid or accrued by persons other than section 902 corporations. In addition, § 1.909–2T(b)(3)(ii)(D) defines a U.S. equity hybrid instrument as an instrument that is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for foreign tax purposes, or with respect to which the issuer is otherwise entitled to a deduction for foreign tax purposes for amounts paid or accrued with respect to the instrument. For example, an instrument that is treated as equity for U.S. Federal income tax purposes but with respect to which amounts paid or accrued by the issuer are treated for foreign tax purposes as a deductible notional interest payment (even though the instrument is otherwise treated as equity for foreign tax purposes) is a U.S. equity hybrid instrument. Under § 1.909–2T(b)(3)(iii)(A), a U.S. equity hybrid instrument is a splitter arrangement if foreign income taxes are paid or accrued by the owner of a U.S. equity hybrid instrument with respect to payments or accruals on or with respect to the instrument that are deductible by the issuer under the laws of a foreign jurisdiction in which the issuer is subject to tax but that do not give rise to income for U.S. Federal income tax purposes.

Under § 1.909–2T(b)(3)(iii)(B), split taxes from a U.S. equity hybrid instrument splitter arrangement equal the total amount of foreign income taxes, including withholding taxes, paid or accrued by the owner of the hybrid instrument less the amount of foreign income taxes that would have been paid or accrued had the owner of the U.S. equity hybrid instrument not been subject to foreign tax on income from the instrument. Under § 1.909–2T(b)(3)(iii)(C), the related income with respect to split taxes from a U.S. equity hybrid instrument splitter arrangement is income of the issuer of the U.S. equity hybrid instrument in an amount equal to the payments or accruals giving rise to the split taxes that are deductible by the issuer for foreign tax purposes, determined without regard to the actual amount of the issuer’s income or earnings and profits for U.S. Federal income tax purposes.

Section 1.909–2T(b)(3)(ii)(D) defines a U.S. debt hybrid instrument as an instrument that is treated as equity for foreign tax purposes but as indebtedness for U.S. Federal income tax purposes. Under § 1.909–2T(b)(3)(ii)(A), a U.S. debt hybrid instrument is a splitter arrangement if foreign income taxes are paid or accrued by the issuer of a U.S. debt hybrid instrument with respect to income in an amount equal to the
interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax. Under §1.909–2T(b)(3)(ii)(B), split taxes from a U.S. debt hybrid instrument splitter arrangement are the foreign income taxes paid or accrued by the issuer on the income that would have been offset by the interest paid or accrued on the U.S. debt hybrid instrument had such interest been deductible for foreign tax purposes. Under §1.909–2T(b)(3)(ii)(C), the related income from a U.S. debt hybrid instrument splitter arrangement is the gross amount of the interest income recognized for U.S. Federal income tax purposes by the owner of the U.S. debt hybrid instrument, determined without regard to the actual amount of the owner’s income or earnings and profits for U.S. Federal income tax purposes.

5. Partnership Inter-Branch Payment Splitter Arrangements

Section 1.909–2T(b)(4) describes a partnership inter-branch payment splitter arrangement. The Treasury Department and the IRS stated in section 5.03 of Notice 2010–92 that future guidance would provide that allocations described in §1.704–1(b)(4)(vii)(d)(3) will result in a foreign tax credit splitting event in post-2010 taxable years to the extent such allocations result in foreign income taxes being allocated to a different partner than the related income.

Under §1.909–2T(b)(4)(i), an allocation of foreign income tax paid or accrued by a partnership with respect to an inter-branch payment as described in §1.704–1(b)(4)(vii)(d)(3) revised as of April 1, 2011) (the inter-branch payment tax), is a splitter arrangement to the extent the inter-branch payment tax is not allocated to the partners in the same proportion as the distributive shares of income in the CFTE category to which the inter-branch payment tax is or would be assigned under §1.704–1(b)(4)(vii)(d) without regard to §1.704–1(b)(4)(vii)(d)(3). Under §1.909–2T(b)(4)(ii), split taxes from a partnership inter-branch payment splitter arrangement equal the excess of the amount of the inter-branch payment tax that would have been allocated to the partner if the tax had been allocated in the same as the distributive shares of income in that CFTE category. Under §1.909–2T(b)(4)(iii), related income from a partnership inter-branch payment splitter arrangement equals the amount of income allocated to a partner that exceeds the amount of income that would have been allocated to the partner if income in that CFTE category in the amount of the inter-branch payment had been allocated to the partners in the same proportion as the inter-branch payment tax was allocated under the partnership agreement.

D. Rules Regarding Related Income and Split Taxes and Coordination Rules

Section 4.06 of Notice 2010–92 provides guidance on determining the amount of related income and pre-2011 split taxes paid or accrued with respect to pre-2011 splitter arrangements. A statement requesting guidance on the treatment of related income and split taxes in the case of certain dispositions that were not described in section 4.06 of Notice 2010–92 (specifically, dispositions of section 902 corporations in transactions other than those that qualify under section 381). The Treasury Department and the IRS expect to issue regulations that provide additional guidance on the interaction between section 909 and other Code provisions such as sections 904(c), 905(a), and 905(c). Until such guidance is issued, §1.909–4T(a) provides that the principles of §1.909–6T(g) (which adopt the rules described in section 4.06 of Notice 2010–92) will apply to related income and split taxes in taxable years beginning or after January 1, 2011.

E. 2011 and Certain 2012 Splitter Arrangements

Section 909 applies to foreign income taxes paid or accrued in taxable years beginning after December 31, 2010. Section 1.909–2T(b), setting forth the exclusive list of splitter arrangements, is effective for foreign income taxes paid or accrued in taxable years beginning on or after January 1, 2012. Notice 2010–92 states that pre-2011 splitter arrangements will give rise to foreign tax credit splitting events in post-2010 taxable years. Accordingly, §1.909–5T(a)(1) provides that foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2011, and before January 1, 2012, in connection with a pre-2011 splitter arrangement (as defined in §1.909–6T(b)), are split taxes to the same extent that such taxes would have been treated as pre-2011 split taxes if such taxes were paid or accrued by a section 902 corporation in a pre-2011 taxable year. The related income with respect to split taxes from such an arrangement is the related income described in §1.909–6T(b), determined as if the payor were a section 902 corporation.

In addition, Notice 2010–92 states that allocations described in §1.704–1(b)(4)(vii)(d)(3) will result in a foreign
tax credit splitting event in post-2010 taxable years to the extent such allocations result in foreign income taxes being allocated to a different partner than the related income. Accordingly, § 1.909–5T(a)(2) provides that foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2011, and before January 1, 2012, in connection with a partnership inter-branch payment splitter arrangement described in § 1.909–2T(b)(4) are split taxes to the extent such taxes are identified as split taxes in § 1.909–2T(b)(4)(ii). The related income with respect to the split taxes is the related income described in § 1.909–2T(b)(4)(iii).

Finally, these temporary regulations provide that foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2012, and on or before February 14, 2012 in connection with a foreign consolidated group splitter arrangement described in § 1.909–6T(b)(2) are split taxes to the same extent that such taxes would have been treated as pre-2011 split taxes if such taxes were paid or accrued by a section 902 corporation in a pre-2011 taxable year. This rule ensures that section 909 applies to suspend foreign tax on income of foreign consolidated groups paid or accrued in post-2010 taxable years to the extent the tax is not apportioned among the members of the group in accordance with the principles of Treas. Reg. § 1.901–2(f)(3). Final regulations published elsewhere in this issue of the Federal Register explicitly apply the ratable allocation rules of Treas. Reg. § 1.901–2(f)(3) to tax paid on combined income of foreign consolidated groups, without regard to whether the group members are jointly and severally liable for the tax under foreign law.

F. Pre-2011 Foreign Tax Credit Splitting Events

Section 1.909–6T adopts the rules described in Notice 2010–92 regarding pre-2011 foreign tax credit splitting events and the application of section 909 to foreign income taxes paid or accrued by a section 902 corporation in pre-2011 taxable years.

Availability of IRS Documents


Effect on Other Documents

The following publication is obsolete as of February 14, 2012:


Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 533(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble of the cross-referenced notice of proposed rulemaking published in this issue of the Federal Register.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Suzanne M. Walsh of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Par. 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.704–1 is amended as follows:

■ Paragraph (b)(0) is amended by adding an entry for § 1.704–1(b)(1)(ii)(b)(3) and revising the entry for § 1.704–1(b)(4)(viii)(d)(3).

■ Paragraph (b)(1)(ii)(b)(3) is added.

■ Paragraph (b)(4)(viii)(c)(3)(ii) is revised.

■ Paragraph (b)(4)(viii)(d)(3) is revised.

Par. 3. Section 1.704–1T is added to read as follows:

§ 1.704–1T Partner’s distributive share (temporary).

(a) Through (b)(1)(ii)(b)(2) [Reserved]. For further guidance, see § 1.704–1T(b)(4)(viii)(d)(3) apply for partnership taxable years beginning on or after January 1, 2012.

(b) Transition rule. Transition relief is provided herein to partnerships whose
agreements were entered into prior to February 14, 2012. In such case, if there has been no material modification to the partnership agreement on or after February 14, 2012, then the partnership may apply the provisions of §1.704–1(b)(4)(iv)(c)(3)(ii) and §1.704–1(b)(4)(iv)(d)(3) (revised as of April 1, 2011). For purposes of this paragraph (b)(1)(iii)(b)(3), any change in ownership constitutes a material modification to the partnership agreement. This transition rule does not apply to any taxable year in which persons bearing a relationship to each other that is specified in section 267(b) or section 707(b) collectively have the power to amend the partnership agreement without the consent of any unrelated party (and all subsequent taxable years).

(b)(1)(iii) through (b)(4)(iv)(d)(2) [Reserved]. For further guidance, see §1.704–1(b)(1)(i) through (b)(4)(iv)(d)(2).

(3) Special rules for inter-branch payments. For rules relating to foreign tax paid or accrued in partnership taxable years beginning before January 1, 2012 in respect of certain inter-branch payments, see 26 CFR 1.704–1(b)(4)(iv)(d)(3) (revised as of April 1, 2011).

(b)(4)(ix) through (b)(5) Example 23 [Reserved]. For further guidance, see §1.704–1(b)(4)(ix) through (b)(5) Example 23.

Example 24. (i) The facts are the same as in Example 21, except that businesses M and N are conducted by entities (DE1 and DE2, respectively) that are corporations for U.S. tax purposes and disregarded for U.S. tax purposes. Also, assume that DE1 makes payments of $75,000 during 2012 to DE2 that are deductible by DE1 for country X tax purposes and includible in income of DE2 for country Y tax purposes. As a result of such payments, DE1 has taxable income of $25,000 for country X purposes on which $10,000 of such taxes are imposed and DE2 has taxable income of $125,000 for country Y purposes on which $25,000 of such taxes are imposed. For U.S. tax purposes, $100,000 of AB’s income is attributable to the activities of DE1 and $50,000 of AB’s income is attributable to the activities of DE2. Pursuant to the partnership agreement, all partnership items from business M, excluding CFTEs paid or accrued by business M, are allocated 75 percent to A and 25 percent to B, and all partnership items from business N, excluding CFTEs paid or accrued by business N, are split evenly between A and B (50 percent each). Accordingly, A is allocated 75 percent of the income from business M ($75,000), and 50 percent of the income from business N ($25,000). B is allocated 25 percent of the income from business M ($25,000), and 50 percent of the income from business N ($25,000).

(ii) Because the partnership agreement provides for different allocations of the net income attributable to businesses M and N, the net income attributable to each of business M and business N is income in separate CFTE categories. See paragraph (b)(4)(iv)(c)(2) of this section. Under paragraph (b)(4)(iv)(c)(3) of this section, the $100,000 of net income attributable to business M is in the business M CFTE category and the $50,000 of net income attributable to business N is in the business N CFTE category. Under paragraph (b)(4)(iv)(d)(1) of this section, the $10,000 of country X taxes is allocated to the business M CFTE category and $10,000 of the country Y taxes is allocated to the business N CFTE category. The additional $15,000 of country Y tax imposed with respect to the inter-branch payment is assigned to the business M CFTE category because for U.S. tax purposes, the related $75,000 of income that country Y is taxing is in the business M CFTE category. Therefore, $25,000 of taxes ($10,000 of country X taxes and $15,000 of the country Y taxes) is related to the $100,000 of net income in the business M CFTE category and the other $10,000 of country Y taxes is related to the $50,000 of net income in the business N CFTE category. The allocations of country X taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners’ interests in the partnership if such taxes are allocated 75 percent to A and 25 percent to B. The allocations of country Y taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners’ interests in the partnership if such taxes are allocated 75 percent to A and 50 percent to B.

Example 25 through (e) [Reserved]. For further guidance, see §1.704–1(b)(5) Example 25 through (e).
§ 1.909–3T Rules regarding related income and split taxes (temporary).

(a) Interim rules for identifying related income and split taxes.
(b) Split taxes on deductible disregarded payments.
(c) Effective/applicability date.
(d) Expiration date.

§ 1.909–4T Coordination rules (temporary).

(a) Interim rules.
(b) Effective/applicability date.
(c) Expiration date.

§ 1.909–5T 2011 and 2012 splitter arrangements (temporary).

(a) Taxes paid or accrued in taxable years beginning in 2011.
(b) Taxes paid or accrued in certain taxable years beginning in 2012 with respect to a foreign consolidated group splitter arrangement.
(c) Effective/applicability date.
(d) Expiration date.

§ 1.909–6T Pre-2011 foreign tax credit splitting events (temporary).

(a) Foreign tax credit splitting event.
(1) In general.
(2) Taxes not subject to suspension under section 909.
(3) Taxes subject to suspension under section 909.
(b) Pre-2011 splitter arrangements.
(1) Reversal hybrid structure splitter arrangements.
(2) Foreign consolidated group splitter arrangements.
(c) Group relief or other loss-sharing regime splitter arrangements.
(i) In general.
(ii) Split taxes and related income.
(d) Hybrid instrument splitter arrangements.
(i) In general.
(ii) U.S. equity hybrid instrument splitter arrangement.
(iii) U.S. debt hybrid instrument splitter arrangement.
(e) General rules for applying section 909 to pre-2011 split taxes and related income.
(1) Annual determination.
(2) Separate categories.
(3) Special rules regarding related income.
(4) Annual adjustments.
(5) Effect of separate limitation losses and deficits.
(6) Pro rata method for distributions out of earnings and profits that include both related income and other income.
(7) Alternative method for distributions out of earnings and profits that include both related income and other income.
(8) Special rules for determining whether related income is taken into account by a section 902 shareholder.
(9) Temporary rules for determining whether related income is taken into account by a foreign corporation.
(10) Distributions of previously-taxed earnings and profits.
(b) Special rules regarding pre-2011 split taxes.
(1) Taxes deemed paid pro rata out of pre-2011 split taxes and other taxes.
(2) Pre-2011 split taxes deemed paid in pre-2011 taxable years.
(3) Carryover of pre-2011 split taxes.
(4) Determining when pre-2011 split taxes are no longer treated as pre-2011 split taxes.
(c) Rules relating to partnerships and trusts.
(1) Rules relating to partnerships.
(2) Section 704(b) allocations.
(3) Trusts.
(4) Other foreign tax credit provisions.
(d) Effective/applicability date.
(e) Expiration date.

Par. 5. Sections 1.909–1T, 1.909–2T, 1.909–3T, 1.909–4T, 1.909–5T, and 1.909–6T are added to read as follows:

§ 1.909–1T Definitions and special rules (temporary).

(a) Definitions. For purposes of section 909, this section, and §§ 1.909–2T through –5T, the following definitions apply:
(1) The term section 902 corporation means any foreign corporation with respect to which one or more domestic corporations meet the ownership requirements of section 902(a) or (b).
(2) The term section 902 shareholder means any domestic corporation that meets the ownership requirements of section 902(a) or (b) with respect to a section 902 corporation.
(3) The term payor means a person that pays or accrues a foreign income tax within the meaning of § 1.901–2(f), and also includes a person that takes foreign income taxes paid or accrued by a partnership, S corporation, estate or trust into account pursuant to section 702(a)(6), section 901(b)(5) or section 1373(a).
(4) The term covered person means, with respect to a payor—
(i) Any entity in which the payor holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value);
(ii) Any person that holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value) in the payor; or
(iii) Any person that bears a relationship that is described in section 267(b) or 707(b) to the payor.
(5) The term foreign income tax means any income, war profits, or excess profits tax paid or accrued to any foreign country or to any possession of the United States. A foreign income tax includes any tax paid in lieu of such a tax within the meaning of section 903.
(6) The term post-1986 foreign income taxes has the meaning provided in § 1.902–1(a)(8).
(7) The term post-1986 undistributed earnings has the meaning provided in § 1.902–1(a)(9).
(8) The term disregarded entity means an entity that is disregarded as an entity separate from its owner, as provided in § 301.7701–2(c)(2)(i).
(9) The term hybrid partnership means a partnership that is subject to income tax in a foreign country as a corporation (or otherwise at the entity level) on the basis of residence, place of incorporation, place of management or similar criteria.
(b) Taxes paid or accrued by a partnership, S corporation or trust. Under section 909(c)(1), section 909 applies at the partner level, and similar rules apply in the case of an S corporation or trust. Accordingly, in the case of foreign income taxes paid or accrued by a partnership, S corporation or trust, taxes allocated to one or more partners, shareholders or beneficiaries (as the case may be) will be treated as split taxes to the extent such taxes would be split taxes if the partner, shareholder or beneficiary had paid or accrued the taxes directly on the date such taxes are taken into account by the partner under sections 702 and 700(a), by the shareholder under section 1373(a), or by the beneficiary under section 901(b)(5). Any such split taxes will be suspended in the hands of the partner, shareholder or beneficiary.
(c) Related income of a partnership, S corporation or trust. For purposes of determining whether related income is taken into account by a covered person, related income of a partnership, S corporation or trust is considered to be taken into account by the partner, shareholder or beneficiary to whom the related income is allocated.
(d) Application of section 909 to pre-1987 accumulated profits and pre-1987 foreign income taxes. Section 909 and §§ 1.909–1T through –5T will apply to pre-1987 accumulated profits (as defined in § 1.902–1(a)(10)(i) and pre-1987 foreign income taxes (as defined in § 1.902–1(a)(10)(ii)) of a section 902 corporation attributable to taxable years beginning on or after January 1, 2012.
(e) Effective/applicability date. This section applies to taxable years beginning on or after January 1, 2011.
(f) Expiration date. The applicability of this section expires on February 9, 2015.
§ 1.909–2T  Splitter arrangements (temporary).

(a) Foreign tax credit splitting event—(1) In general. There is a foreign tax credit splitting event with respect to foreign income taxes paid or accrued if and only if, in connection with an arrangement described in paragraph (b) of this section (a splitter arrangement) the related income was, is or will be taken into account for U.S. Federal income tax purposes by a person that is a covered person with respect to the payor of the tax. Foreign income taxes that are paid or accrued in connection with a splitter arrangement are split taxes to the extent provided in paragraph (b) of this section. Income (or, as appropriate, earnings and profits) that was, is or will be taken into account by a covered person in connection with a splitter arrangement is related income to the extent provided in paragraph (b) of this section.

(2) Split taxes not taken into account. Split taxes will not be taken into account for Federal income tax purposes before the taxable year in which the related income is taken into account by the payor or, in the case of split taxes paid or accrued by a section 902 corporation, by a section 902 shareholder of such section 902 corporation. Therefore, in the case of split taxes paid or accrued by a section 902 corporation, split taxes will not be taken into account for purposes of sections 902 or 960, or for purposes of determining earnings and profits under section 964(a), before the taxable year in which the related income is taken into account by the payor section 902 corporation, or, in the case of split taxes paid or accrued by a section 902 corporation, by a section 902 shareholder of such section 902 corporation. A foreign tax credit splitting event with respect to income of the reverse hybrid that gave rise to income included in the payor’s foreign tax base with respect to which the split taxes were paid or accrued.

(b) Splitter arrangements. The arrangements set forth in this paragraph (b) are splitter arrangements.

(1) Reverse hybrid splitter arrangement—(i) In general. A reverse hybrid is a splitter arrangement when a payor pays or accrues foreign income taxes with respect to income of a reverse hybrid. A reverse hybrid splitter arrangement exists even if the reverse hybrid has a loss or a deficit in earnings and profits for a particular year for U.S. Federal income tax purposes (for example, due to a timing difference).

(ii) Split taxes from a reverse hybrid splitter arrangement. The foreign income taxes paid or accrued with respect to income of the reverse hybrid are split taxes to the extent provided in paragraph (b) of this section. Income (or, as appropriate, earnings and profits) that was, is or will be taken into account by a covered person in connection with a splitter arrangement is related income to the extent provided in paragraph (b) of this section. Income (or, as appropriate, earnings and profits) that was, is or will be taken into account by a covered person in connection with a splitter arrangement is related income to the extent provided in paragraph (b) of this section.

(iii) Related income from a reverse hybrid splitter arrangement. The related income with respect to split taxes from a reverse hybrid splitter arrangement is the earnings and profits (computed for U.S. Federal income tax purposes) of the reverse hybrid attributable to the activities of the reverse hybrid that gave rise to income included in the payor’s foreign tax base with respect to which the split taxes were paid or accrued. Accordingly, related income of the reverse hybrid only includes items of income or expense attributable to a disregarded entity owned by the reverse hybrid to the extent that the income attributable to the activities of the disregarded entity is included in the payor’s foreign tax base.

(iv) Reverse hybrid. The term reverse hybrid means an entity that is a corporation for U.S. Federal income tax purposes but is a fiscally transparent entity (under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

(c) Loss-sharing splitter arrangement. In general. A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group (usable shared loss) but is used instead to offset income of another U.S. combined income group.

(d) U.S. combined income group. The term U.S. combined income group means an individual or a corporation and all entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

(e) Loss-sharing splitter arrangement. In general. A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group (usable shared loss) but is used instead to offset income of another U.S. combined income group.

(f) U.S. combined income group. The term U.S. combined income group means an individual or a corporation and all entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

(g) Loss-sharing splitter arrangement. In general. A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group (usable shared loss) but is used instead to offset income of another U.S. combined income group.

(h) U.S. combined income group. The term U.S. combined income group means an individual or a corporation and all entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

(i) Loss-sharing splitter arrangement. In general. A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group (usable shared loss) but is used instead to offset income of another U.S. combined income group.

(j) U.S. combined income group. The term U.S. combined income group means an individual or a corporation and all entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of § 1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.
shared loss of the entity is allocated between or among the groups under foreign tax law. In the case of an entity that is not fiscally transparent for foreign tax purposes and that is a member of more than one U.S. combined income group, the shared loss of that entity will be allocated between or among those groups based on U.S. Federal income tax principles. For example, in the case of a hybrid partnership, the shared loss of the partnership will be allocated between or among the groups in the manner the partnership allocates the loss under section 704(b). To the extent the shared loss would be a loss under U.S. tax principles in another year, the loss is allocated between or among the groups based on how the partnership would allocate the loss if the loss were recognized for U.S. tax purposes in the year in which the loss is recognized for foreign tax purposes. To the extent the shared loss would not constitute a loss under U.S. tax principles in any year, the loss is allocated between or among the groups in the same manner as the partnership items attributable to the activity giving rise to the shared loss.

(iv) Split taxes from a loss-sharing splitter arrangement. Split taxes from a loss-sharing splitter arrangement are foreign income taxes paid or accrued by a member of the U.S. combined income group with respect to income equal to the amount of the usable shared loss of that group that offsets income of another U.S. combined income group.

(v) Related income from a loss-sharing splitter arrangement. The related income with respect to split taxes from a loss-sharing splitter arrangement is an amount of income of the individual or corporate member of the U.S. combined income group equal to the amount of income of that U.S. combined income group that is offset by the usable shared loss of another U.S. combined income group.

(v) Foreign group relief or other loss-sharing regime. A foreign group relief or other loss-sharing regime exists when an entity may surrender its loss to offset the income of one or more other entities. A foreign group relief or other loss-sharing regime does not include an allocation of loss of an entity that is a partnership or other fiscally transparent entity (under the principles of § 1.894–1(d)(3)) for foreign tax purposes or regimes in which foreign tax is imposed on combined income (such as a foreign consolidated regime), as described in § 1.901–2(f)(3).

Example 1. (i) Facts. USP, a domestic corporation, wholly owns CFC1, a corporation organized in country A. CFC1 wholly owns CFC2 and CFC3, both corporations organized in country A. CFC2 wholly owns DE, an entity organized in country B. DE is a corporation in which the income and loss of CFC2 are combined for Federal income tax purposes. CFC1 and CFC2 each have their own separate U.S. combined income group. Pursuant to § 1.909–2T(b)(2)(iv), the income of CFC1 is combined for U.S. Federal income tax purposes. CFC2 and CFC3 each have their own separate U.S. combined income group. DE is a disregarded entity.

(ii) Result. Pursuant to § 1.909–2T(b)(2)(ii) and § 1.901–2(f)(3), CFC2 DE constitute one U.S. combined income group, while CFC1 and CFC3 each constitute separate U.S. combined income groups. Pursuant to § 1.909–2T(b)(2)(iii)(A), the income of the CFC2 CFC3 combined income group is 50u (CFC2's country A taxable income plus 50u of CFC3's country A taxable income). Pursuant to § 1.909–2T(b)(2)(iii)(B), the shared loss of the CFC2 U.S. combined income group includes the 100u of shared loss incurred by DE. The usable shared loss of the CFC2 U.S. combined income group is 50u, the amount of the group's shared loss that could have otherwise offset CFC2's 50u of country A taxable income that is included in the income of the CFC2 U.S. combined income group. There is a splitter arrangement because the 50u usable shared loss of the CFC2 U.S. combined income group was used instead to offset income of CFC3, which is included in the CFC3 U.S. combined income group. Pursuant to § 1.909–2T(b)(2)(iv), the split taxes are the 15u of country A tax paid by CFC3 on 50u of income, an amount of income of the CFC2 U.S. combined income group equal to the amount of usable shared loss of that group that was used to offset income of the CFC3 U.S. combined income group. Pursuant to § 1.909–2T(b)(2)(iv), the related income is the 50u of CFC3's income that equals the amount of income of the CFC3 U.S. combined income group that was offset by the usable shared loss of the CFC2 U.S. combined income group.

Example 2. (i) Facts. USP, a domestic corporation, wholly owns CFC1, a corporation organized in country B. CFC1 wholly owns CFC2 and CFC3, both corporations organized in country B. CFC2 wholly owns DE, an entity organized in country B. DE is a corporation for country B tax purposes and a disregarded entity for U.S. Federal income tax purposes. CFC1 and CFC2 each have their own separate U.S. combined income group. DE, and HP1 is a corporation in which the income and loss of CFC2 are combined for country B tax purposes and a disregarded entity. For U.S. Federal income tax purposes, CFC2 and CFC3 each have their own separate U.S. combined income groups. DE is a disregarded entity.

(ii) Result. Pursuant to § 1.909–2T(b)(2)(ii), because the income and loss of HP1 are combined in part with the income and loss of both CFC2 and CFC3, it belongs to both of the separate CFC2 and CFC3 U.S. combined income groups. DE is a member of the CFC2 U.S. combined income group.

(iii) Income of the U.S. combined income groups. Pursuant to § 1.909–2T(b)(2)(iii)(A), the income of the CFC2 U.S. combined income group is 200u country B taxable income of the members of the group with
positive taxable incomes (CFC2’s country B taxable income of 100u + 50% of HP1’s country B taxable income of 200u, or 100u). Because DE does not have positive taxable income for country B tax purposes, its 100u loss is not included in the income of the CFC2 U.S. combined income group. The income of the CFC2 U.S. combined income group is 100u (50% of HP1’s country B taxable income of 200u, or 100u).

(iv) Shared loss of the U.S. combined income groups. Pursuant to §1.909–2T(b)(2)(v), the related income is the U.S. combined income group’s usable shared loss 50u of the CFC3’s income that was offset by the 50u of HP1’s income from the instrument.

(v) Income offset by shared loss. The CFC2 U.S. combined income group has no shared loss. Pursuant to §1.909–2T(b)(2)(v), the usable shared loss of the CFC2 U.S. combined income group is 100u, the full amount of the group’s 100u shared loss that could have been used to offset the income of the CFC2 U.S. combined income group had the loss been used to offset 100u of CFC2’s country B taxable income.

(vi) Splitter arrangement. There is a splitter arrangement because 50u of the 100u shared loss of the CFC2 U.S. combined income group was used to offset income of the CFC2 U.S. combined income group. Pursuant to §1.909–2T(b)(2)(iv), the split taxes are the 15u of country B income tax paid by CFC2 on 50u of its income, which is equal to the amount of the CFC2 U.S. combined income group’s usable shared loss that was used to offset income of another U.S. combined income group. Pursuant to §1.909–2T(b)(2)(v), the related income is the 50u of CFC3’s income that was offset by the usable shared loss of the CFC2 U.S. combined income group.

(3) Hybrid instrument splitter arrangements—(i) U.S. equity hybrid instrument splitter arrangement—(A) In general. A U.S. equity hybrid instrument is a splitter arrangement if payments or accruals on or with respect to such instrument:

(1) Do not give rise to foreign income taxes paid or accrued by the owner of such instrument;

(2) Are deductible by the issuer under the laws of a foreign jurisdiction in which the issuer is subject to tax; and

(3) Do not give rise to income for U.S. Federal income tax purposes.

(B) Split taxes from a U.S. equity hybrid instrument splitter arrangement. Split taxes from a U.S. equity hybrid instrument splitter arrangement equal the total amount of foreign income taxes paid or accrued by the owner of the hybrid instrument less the amount of foreign income taxes that would have been paid or accrued by the owner of the U.S. equity hybrid instrument not subject to foreign tax on income from the instrument.

(C) Related income from a U.S. equity hybrid instrument splitter arrangement. The related income with respect to split taxes from a U.S. equity hybrid instrument splitter arrangement is income of the issuer of the U.S. equity hybrid instrument in an amount equal to the payments or accruals giving rise to the split taxes that are deductible by the issuer for foreign tax purposes, determined without regard to the actual amount of the issuer’s income or earnings and profits for U.S. Federal income tax purposes.

(4) U.S. equity hybrid instrument. The term U.S. equity hybrid instrument means an instrument that is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for foreign tax purposes, or with respect to which the issuer is otherwise entitled to a deduction for foreign tax purposes for amounts paid or accrued with respect to the instrument.

(ii) U.S. debt hybrid instrument splitter arrangement—(A) In general. A U.S. debt hybrid instrument is a splitter arrangement if foreign income taxes are paid or accrued by the issuer of a U.S. debt hybrid instrument with respect to income in an amount equal to the interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax.

(B) Split taxes from a U.S. debt hybrid instrument splitter arrangement. Split taxes from a U.S. debt hybrid instrument splitter arrangement are the foreign income taxes paid or accrued by the issuer on the income that would have been offset by the interest paid or accrued on the U.S. debt hybrid instrument had such interest been deductible for foreign tax purposes.

(C) Related income from a U.S. debt hybrid instrument splitter arrangement. The related income from a U.S. debt hybrid instrument splitter arrangement is the gross amount of the interest income recognized for U.S. Federal income tax purposes by the owner of the U.S. debt hybrid instrument, determined without regard to the actual amount of the owner’s income or earnings and profits for U.S. Federal income tax purposes.

(D) U.S. debt hybrid instrument. The term U.S. debt hybrid instrument means an instrument that is treated as equity for foreign tax purposes but as
only to identify the amount of pre-2011 split taxes of a section 902 corporation that are suspended as of the first day of the section 902 corporation’s first taxable year beginning on or after January 1, 2011.

(b) Split taxes on deductible disregarded payments. Split taxes include taxes paid or accrued in taxable years beginning on or after January 1, 2011, with respect to the amount of a disregarded payment that is deductible by the payor of the disregarded payment under the laws of a foreign jurisdiction in which the payor of the disregarded payment is subject to tax on related income from a splitter arrangement. The amount of the deductible disregarded payment to which this paragraph (b) applies is limited to the amount of related income from such splitter arrangement.

(c) Effective/applicability date. The rules of this section apply to taxable years beginning on or after January 1, 2011.

(d) Expiration date. The applicability of this section expires on February 9, 2015.

§ 1.909–4T Coordination rules (temporary).

(a) Interim rules. The principles of paragraph (g) of § 1.909–6T apply to taxable years beginning on or after January 1, 2011.

(b) Effective/applicability date. The rules of this section apply to taxable years beginning on or after January 1, 2011.

(c) Expiration date. The applicability of this section expires on February 9, 2015.

§ 1.909–5T 2011 and 2012 splitter arrangements (temporary).

(a) Taxes paid or accrued in taxable years beginning in 2011. (1) Foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2011, and before January 1, 2012, in connection with a pre-2011 splitter arrangement described in § 1.909–2T(b)(4) are split taxes to the extent that such taxes are identified as split taxes in § 1.909–2T(b)(4)(ii). The related income with respect to the split taxes is the related income described in § 1.909–2T(b)(4)(iii).

(b) Taxes paid or accrued in certain taxable years beginning in 2012 with respect to a foreign consolidated group splitter arrangement. Foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2012, and on or before February 14, 2012, in connection with a foreign consolidated group splitter arrangement described in § 1.909–6T(b)(2) are split taxes to the same extent that such taxes would have been treated as pre-2011 split taxes if such taxes were paid or accrued by a section 902 corporation in a taxable year beginning on or before December 31, 2010. The related income with respect to split taxes from such an arrangement is the related income described in § 1.909–6T(b)(2), determined as if the payor were a section 902 corporation.

(c) Effective/applicability date. The rules of this section apply to foreign taxes paid or accrued in taxable years beginning on or after January 1, 2011, and on or before February 14, 2012.

(d) Expiration date. The applicability of this section expires on February 9, 2015.

§ 1.909–6T Pre-2011 foreign tax credit splitting events (temporary).

(a) Foreign tax credit splitting event—(1) In general. This section provides rules for determining whether foreign income taxes paid or accrued by a section 902 corporation (as defined in section 909(d)(5)) in taxable years beginning on or before December 31, 2010 (pre-2011 taxable years and pre-2011 taxes) are suspended under section 909 in taxable years beginning after December 31, 2010 (post-2010 taxable years) of a section 902 corporation. Paragraph (b) of this section identifies an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events in pre-2011 taxable years (pre-2011 splitter arrangements). Paragraphs (c), (d), and (e) of this section provide rules for determining the related income and pre-2011 split taxes paid or accrued with respect to pre-2011 splitter arrangements. Paragraph (f) of this section provides rules concerning the application of section 909 to partnerships and trusts. Paragraph (g) of this section provides rules concerning the interaction between section 909 and other Internal Revenue Code (Code) provisions.

(b) Pre-2011 splitter arrangements. The arrangements set forth in this paragraph (b) are pre-2011 splitter arrangements.

(1) Reverse hybrid structure splitter arrangements. A reverse hybrid structure exists when a section 902 corporation owns an interest in a reverse hybrid. A reverse hybrid is an entity that is a corporation for U.S. Federal income tax purposes but is a pass-through entity or a branch under the laws of a foreign country imposing tax on the income of the entity. As a result, the owner of the reverse hybrid...
is subject to tax on the income of the entity under foreign law. A pre-2011 splitter arrangement involving a reverse hybrid structure exists when pre-2011 taxes are paid or accrued by a section 902 corporation with respect to income of a reverse hybrid that is a covered person with respect to the section 902 corporation. A pre-2011 splitter arrangement involving a reverse hybrid structure may exist even if the reverse hybrid has a deficit in earnings and profits for a particular year (for example, due to a timing difference). Such taxes paid or accrued by the section 902 corporation are pre-2011 split taxes. The related income is the earnings and profits (computed for U.S. Federal income tax purposes) of such other member attributable to the activities of that other member that gave rise to income included in the foreign tax base with respect to which the pre-2011 split taxes were paid or accrued. No inference should be drawn from the treatment of foreign consolidated groups under section 909 as to the determination of the person who paid the foreign income tax for U.S. Federal income tax purposes.

(3) Group relief or other loss-sharing regime splitter arrangements—(i) In general. A foreign group relief or other loss-sharing regime exists when one entity with a loss permits the loss to be used to offset the income of one or more entities (shared loss). A pre-2011 splitter arrangement involving a shared loss exists when the following three conditions are met:

(A) There is an instrument that is treated as indebtedness under the laws of the jurisdiction in which the issuer is subject to tax and that is disregarded for U.S. Federal income tax purposes (disregarded debt instrument). Examples of a disregarded debt instrument include a debt obligation between two disregarded entities that are owned by the same section 902 corporation, two disregarded entities that are owned by a partnership with one or more partners that are section 902 corporations, a section 902 corporation and a disregarded entity that is owned by that section 902 corporation, or a partnership in which the section 902 corporation is a partner and a disregarded entity that is owned by such partnership.

(B) The owner of the disregarded debt instrument pays a foreign income tax attributable to a payment or accrual on the instrument.

(C) The payment or accrual on the disregarded debt instrument gives rise to a deduction for foreign tax purposes in the jurisdiction in which the issuer of the instrument incurs a shared loss that is taken into account under foreign law by one or more entities that are covered persons with respect to the owner of the instrument.

(ii) Split taxes and related income. In situations described in paragraph (b)(3)(i) of this section, pre-2011 taxes paid or accrued by the owner of the disregarded debt instrument with respect to amounts paid or accrued on the instrument (up to the amount of the shared loss) are pre-2011 split taxes. The related income of a covered person is an amount equal to the shared loss, determined without regard to the actual amount of the covered person’s earnings and profits.

(4) Hybrid instrument splitter arrangements—(i) In general. A hybrid instrument for purposes of this paragraph (b)(4) is an instrument that either is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for foreign tax purposes (U.S. equity hybrid instrument), or is treated as indebtedness for U.S. Federal income tax purposes but is treated as equity for foreign tax purposes (U.S. debt hybrid instrument).

(ii) U.S. equity hybrid instrument splitter arrangement. If the issuer of a U.S. equity hybrid instrument is a covered person with respect to a section 902 corporation that is the owner of the U.S. equity hybrid instrument, there is a pre-2011 splitter arrangement with respect to the portion of the pre-2011 taxes paid or accrued by the owner section 902 corporation with respect to the amounts on the instrument that are deductible by the issuer as interest under the laws of a foreign jurisdiction in which the issuer is subject to tax. Pre-2011 split taxes paid or accrued by the section 902 corporation equal the total amount of pre-2011 taxes paid or accrued by the section 902 corporation less the amount of pre-2011 taxes that would have been paid or accrued had the section 902 corporation not been subject to tax on income from the U.S. equity hybrid instrument. The related income of the issuer of the U.S. equity hybrid instrument is an amount equal to the amounts that are deductible by the issuer for foreign tax purposes determined without regard to the actual amount of the issuer’s earnings and profits.

(iii) U.S. debt hybrid instrument splitter arrangement. If the owner of a U.S. debt hybrid instrument is a covered person with respect to a section 902 corporation that is the issuer of the U.S. debt hybrid instrument, there is a pre-2011 splitter arrangement with respect to the portion of the pre-2011 taxes paid or accrued by the section 902 corporation on income in an amount equal to the interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax. Pre-2011 split taxes are the pre-2011 taxes paid or accrued by the section 902 corporation on the income that would have been offset by the interest paid or accrued on the U.S. debt hybrid instrument had such interest been deductible for foreign tax purposes. The
related income with respect to a U.S. debt hybrid instrument is the gross amount of the interest income recognized for U.S. Federal income tax purposes by the owner of the U.S. debt hybrid instrument, determined without regard to the actual amount of the owner’s earnings and profits.

(c) General rules for applying section 909 to pre-2011 split taxes and related income—(1) Annual determination. The determination of related income, other income, pre-2011 split taxes, and other taxes, and the portion of these amounts that were distributed, deemed paid or otherwise transferred or eliminated must be made on an annual basis beginning with the first taxable year of the section 902 corporation beginning after December 31, 1996 (post-1996 taxable year) in which the section 902 corporation paid or accrued a pre-2011 tax with respect to a pre-2011 splitter arrangement and ending with the section 902 corporation’s last pre-2011 taxable year. Annual amounts of related income and pre-2011 split taxes are aggregated for each separate pre-2011 splitter arrangement.

(2) Separate categories. The determination of annual and aggregate amounts of related income and pre-2011 split taxes with respect to each pre-2011 splitter arrangement must be made for each separate category as defined in §1.904–4(m) of the section 902 corporation, each covered person, and any other person that succeeds to the related income and pre-2011 split taxes. In the case of a pre-2011 splitter arrangement involving a shared loss (as described in paragraph (b)(3) of this section), the amount of the related income in each separate category of the covered person is equal to the amount of income in that separate category that was offset by the shared loss for foreign tax purposes. In the case of a pre-2011 splitter arrangement involving a U.S. equity hybrid instrument (as described in paragraph (b)(4)(ii) of this section), the related income is assigned to the issuer’s separate categories in the same proportions as the pre-2011 split taxes.

Earnings and profits, including related income, are assigned to separate categories under the rules of §§1.904–4, 1.904–5, and 1.904–7. Foreign income taxes, including pre-2011 split taxes, are assigned to separate categories under the rules of §1.904–6. A section 902 shareholder must consistently apply methodologies for determining pre-2011 split taxes and related income with respect to all pre-2011 splitter arrangements.

Annual adjustments. In the case of each pre-2011 splitter arrangement involving a reverse hybrid or a foreign consolidated group (as described in paragraphs (b)(1) and (b)(2) of this section, respectively), a covered person’s aggregate amount of related income must be adjusted each year by the net amount of income and expense attributable to the activities of the covered person that give rise to income included in the foreign tax base, even if the net amount is negative and regardless of whether the section 902 corporation paid or accrued any pre-2011 split taxes in such year.

(ii) Effect of separate limitation losses and deficits. Related income is determined without regard to the application of §1.960–1(i)(4) (relating to the effect of separate limitation losses on earnings and profits in another separate category) or section 952(c)(1) (relating to certain earnings and profits deficits).

(3) Pro rata method for distributions out of earnings and profits that include both related income and other income. If the earnings and profits of a covered person include amounts attributable to both related income and other income, including earnings and profits attributable to taxable years beginning before January 1, 1997, then distributions, deemed distributions, and inclusions out of earnings and profits (for example, under sections 301, 304, 367(b), 951(a), 964(e), 1248, or 1293) of the covered person are considered made out of related income and other income on a pro rata basis. Any reduction of a covered person’s earnings and profits that results from a payment on stock that is not treated as a dividend for U.S. Federal income tax purposes (for example, pursuant to section 312(n)(7)) will also reduce related income and other income on a pro rata basis.

(4) Alternative method for distributions out of earnings and profits that include both related income and other income. Solely for purposes of identifying the amount of pre-2011 split taxes of a section 902 corporation that are suspended as of the first day of the section 902 corporation’s first post-2010 taxable year, in lieu of the rule set forth in paragraph (d)(3) of this section, a section 902 shareholder may choose to treat all distributions, deemed distributions, and inclusions out of earnings and profits of a covered person as attributable first to related income. A section 902 shareholder may choose to use this alternative method on a timely filed original income tax return for the first post-2010 taxable year in which the shareholder computes an amount of foreign income tax paid with respect to a section 902 corporation that paid or accrued pre-2011 split taxes.

Such choice by a section 902 shareholder is evidenced by employing the method on its income tax return; the section 902 shareholder need not file a separate statement. A section 902 shareholder that chooses this alternative method must consistently apply it with respect to all pre-2011 splitter arrangements.

(5) Distributions, deemed distributions, and inclusions of related income. Distributions, deemed distributions, and inclusions of related income (including indirectly through a partnership) to persons other than the payor section 902 corporation retain their character as related income with respect to the associated pre-2011 split taxes.

(6) Carryover of related income. Related income carries over to other corporations in the same manner as earnings and profits carry over under section 381, §1.367(b)–7, or similar rules, and retains its character as related income with respect to the associated pre-2011 split taxes.

(7) Related income taken into account by a section 902 shareholder. Related income will be considered taken into account by a section 902 shareholder to the extent that the related income is recognized as gross income by the section 902 shareholder, or by an affiliated corporation described in paragraph (d)(9) of this section, upon a distribution, deemed distribution, or inclusion (such as under section 951(a)) out of the earnings and profits of the covered person attributable to such related income.

(8) Related income taken into account by a payor section 902 corporation. Related income will be considered taken into account by a payor section 902 corporation if:

(i) The related income is reflected in the earnings and profits of such section 902 corporation for U.S. Federal income tax purposes by reason of a distribution, deemed distribution, or inclusion out of the earnings and profits of the covered person attributable to such related income; or

(ii) The payor section 902 corporation and the covered person are combined in a transaction described in section 381(a)(1) or (a)(2).

(9) Related income taken into account by an affiliated group of corporations that includes a section 902 shareholder. A section 902 shareholder will be considered to have taken related income into account if one or more members of an affiliated group of corporations (as defined in section 1504) that files a consolidated Federal income tax return that includes the section 902
(10) Distributions of previously-taxed earnings and profits. Distributions and deemed distributions described in paragraph (d) of this section (including in the case of a section 902 shareholder that has chosen the alternative method described in paragraph (d)(4) of this section) do not include distributions of amounts described in section 959(c)(1) or (c)(2), which are distributed before amounts described in section 959(c)(3).

(e) Special rules regarding pre-2011 split taxes—(1) Taxes deemed paid pro-rata out of pre-2011 split taxes and other taxes. If the pre-2011 taxes of a section 902 corporation include both pre-2011 split taxes and other taxes, then foreign taxes deemed paid under section 902 or after 960 or otherwise removed from post-1986 foreign income taxes in pre-2011 taxable years will be treated as attributable to pre-2011 split taxes and other taxes on a pro-rata basis. Pre-2011 split taxes deemed paid in pre-2011 taxable years in connection with a dividend paid to a shareholder described in section 902(b) retain their character as pre-2011 split taxes. The section 902(b) shareholder will be treated as the payor section 902 corporation with respect to those pre-2011 split taxes.

(3) Carryover of pre-2011 split taxes. Pre-2011 split taxes that carry over to another foreign corporation, including under section 381, § 1.367(b)–7 or similar rules, retain their character as pre-2011 split taxes. The transferee foreign corporation will be treated as the payor section 902 corporation with respect to those pre-2011 split taxes.

(4) Determining when pre-2011 split taxes are no longer treated as pre-2011 split taxes. For each pre-2011 splitter arrangement, as related income is taken into account by the payor section 902 corporation or a section 902 shareholder as provided in paragraph (d) of this section, a ratable portion of the associated pre-2011 split taxes will no longer be treated as pre-2011 split taxes. In the case of a pre-2011 splitter arrangement involving a reverse hybrid or a foreign consolidated group (as described in paragraphs (b)(1) and (b)(2) of this section, respectively), if aggregate related income is reduced to zero (other than as a result of a distribution, deemed distribution, or inclusion described in paragraph (d) of this section) or less than zero, pre-2011 split taxes will retain their character as pre-2011 split taxes until the amount of aggregate related income is positive and the related income is taken into account by the payor section 902 corporation or a section 902 shareholder as provided in paragraph (d) of this section.

(f) Rules relating to partnerships and trusts—(1) Taxes paid or accrued by partnerships. In the case of foreign income taxes paid or accrued by a partnership, the taxes will be treated as pre-2011 split taxes to the extent such taxes are allocated to one or more section 902 corporations and would be pre-2011 split taxes if the partner section 902 corporation had paid or accrued the taxes directly on the date such taxes are included by the section 902 corporation under sections 702 and 706(a). Further, any foreign income taxes subject to section 909 will be suspended in the hands of the partner section 902 corporation.

(2) Section 704(b) allocations. Partnership allocations that satisfy the requirements of section 704(b) and the regulations thereunder will not constitute pre-2011 splitter arrangements except to the extent the arrangement is otherwise described in paragraph (b) of this section (for example, a payment or accrual on a disregarded debt instrument that gives rise to a shared loss).

(3) Trusts. Rules similar to the rules of paragraph (f)(1) of this section will apply in the case of any trust with one or more beneficiaries that is a section 902 corporation.

(g) Interaction between section 909 and other Code provisions—(1) Section 904(c). Section 909 does not apply to excess foreign income taxes that were paid or accrued in pre-2011 taxable years and carried forward and deemed paid or accrued under section 904(c) in a post-2010 taxable year.

(2) Section 905(a). For purposes of determining in post-2010 taxable years the allowable deduction for foreign income taxes paid or accrued under section 164(a), the carryover of excess foreign income taxes under section 904(c), and the extended period for claiming a credit or refund under section 6511(d)(3)(A), foreign income taxes to which section 909 applies are first taken into account and treated as paid or accrued in the year in which the related income is taken into account, and not in the earlier year to which the tax relates (determined without regard to section 909).

(3) Section 905(c). If a readetermination of foreign taxes claimed as a direct credit under section 901 occurs in a post-2010 taxable year and the foreign tax readetermination relates to a pre-2011 taxable year, to the extent such foreign tax readetermination increases the amount of foreign income taxes paid or accrued with respect to the pre-2011 taxable year (for example, due to an additional assessment of foreign tax or a payment of a previously accrued tax not paid within two years), section 909 will not apply to such taxes. If a readetermination of foreign tax paid or accrued by a section 902 corporation occurs in a post-2010 taxable year and increases the amount of foreign income taxes paid or accrued by the section 902 corporation with respect to a pre-2011 taxable year (for example, due to an additional assessment of foreign tax or a payment of a previously accrued tax not paid within two years), such taxes will be treated as pre-2011 taxes. Section 909 will apply to such taxes if they are pre-2011 split taxes and the taxes will be suspended in the post-2010 taxable year in which they would otherwise be taken into account as a prospective adjustment to the section 902 corporation’s pools of post-1986 foreign income taxes.

(4) Other foreign tax credit provisions. Section 909 does not affect the applicability of other restrictions or limitations on the foreign tax credit under existing law, including, for example, the substantiation requirements of section 905(b).

(5) Effective/applicability date. This section applies to foreign income taxes paid or accrued by section 902 corporations in post-2011 taxable years for purposes of computing foreign income taxes deemed paid with respect to distributions or inclusions out of earnings and profits of section 902 corporations in taxable years of the section 902 corporation beginning after December 31, 2010.

(i) Expiration date. The applicability of this section expires on February 9, 2015.