No. 18-1862

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

SIH PARTNERS LLLP, EXPLORER CORPORATION,
Tax Matters Partner,

Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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GLOSSARY

APA	Administrative Procedure Act
Br.	opening brief filed by appellant
CFC	controlled foreign corporation
Doc.	Tax Court docket entries
IRS	Internal Revenue Service
JA	Joint Appendix
Op/JA	Tax Court opinion as paginated in Joint Appendix
SEHL	Susquehanna Europe Holdings Limited
SIHL	Susquehanna Ireland Holdings Limited
SIHP	appellant SIH Partners LLLP
STS	Susquehanna Trading Services, Inc.

STATEMENT OF THE ISSUES

1. Whether the Tax Court correctly determined, under §§ 951, 956[1] and related regulations, that a U.S. partnership was required to include in its income the earnings of its controlled foreign corporations due to their guarantees of a loan to a U.S. affiliate.

2. Whether the Tax Court correctly determined that amounts included in the partnership's income did not qualify under § 1(h)(11) for preferential tax rates applicable to qualified dividend income.

STATEMENT OF RELATED CASES

This case has not been before this Court previously. A related case (regarding subsequent tax years) is pending in the Tax Court.

STATEMENT OF THE CASE

A. Procedural overview

This tax case involves two controlled foreign corporations (CFCs) that invested in U.S. property by guaranteeing a U.S. affiliate's $1.5 billion[2] loan. The CFCs are wholly owned by their U.S. shareholder, appellant SIH Partners LLLP (SIHP). Under §§ 951, 956 of the

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[1] All "§" references are to the Internal Revenue Code (26 U.S.C.). All "Reg. §" references are to Treasury regulations (26 C.F.R.).

[2] All dollar figures are approximations.

Internal Revenue Code and the related Treasury regulations, if a CFC invests in U.S. property by guaranteeing a U.S. affiliate's obligation, then its U.S. shareholders must include in their income the CFCs' "applicable earnings" (up to the amount of the loan). Applying this long-standing rule to the guarantees at issue here, the Commissioner determined that SIHP must include in income $380 million of its CFCs earnings during the tax years at issue. The Commissioner further determined that these income inclusions did not qualify for the preferential tax rates applicable to qualified dividend income (§ 1(h)(11)) because the CFCs' investments in U.S. property were not dividends issued to SIHP. After SIHP petitioned the Tax Court for review of these determinations, the parties cross-moved for summary judgment. The court denied SIHP's motion and granted that of the Commissioner. SIHP has appealed.

B. Background

The United States taxes the income of its citizens and residents on a worldwide basis, subjecting the income from domestic and foreign activities to the same tax burden (and providing a foreign tax credit to alleviate double taxation). §§ 61(a), 901-909. Therefore, when

calculating its income for U.S. tax purposes, a U.S. partnership like SIHP must include income earned abroad. U.S. taxpayers, however, are able to limit worldwide taxation on their foreign income to some extent by separately incorporating their foreign operations. Prior to 1962, the earnings of foreign corporations that were controlled by U.S. taxpayers escaped U.S. taxation until distributed by the foreign corporation to the U.S. taxpayer, even though the U.S. taxpayer would otherwise be subject to full U.S. taxation on foreign income earned by it directly. S. Rep. 87-1881, at 78 (1962). "Congress viewed this [tax] deferral as a privilege," and sought to limit it. Tax Management Portfolio, *CFCs – Investment of Earnings in U.S. Property* A-1 (2013) (describing § 956's history).

To limit that privilege, Congress enacted Subpart F of the Code (§§ 951-965), which restricts tax deferral on foreign income for U.S. shareholders of CFCs.[3] Subpart F taxes a U.S. shareholder directly on two categories of CFC earnings, even though the earnings are not distributed to the U.S. shareholder. First, U.S. shareholders must

[3] CFC is defined in § 957(a). U.S. shareholder is defined in § 951(b).

include in income certain types of CFC earnings (referred to as Subpart F income), such as income from passive investments made by the CFC abroad. § 951(a)(1)(A). Second, and as pertinent here, U.S. shareholders must include in income their CFC's earnings that are directly or indirectly invested in certain types of U.S. property (as defined in § 956). § 951(a)(1)(B). Such earnings are deemed by Congress to have been repatriated for U.S. tax purposes even though the earnings are retained by the CFC. As Congress has explained, "the use of untaxed earnings of a [CFC] to invest in U.S. property was 'substantially the equivalent of a dividend' being paid to U.S. shareholders." S. Rep. 94-938, at 225 (1976).

Section 956 defines "United States property" in categorical terms. A CFC has invested in U.S. property if it acquires (i) tangible property located in the United States, (ii) stock of a U.S. company, (iii) "an obligation of a United States person," or (iv) the right to use certain intangibles in the United States. § 956(c)(1)(A)-(D). And (as pertinent here) if a CFC pledges or guarantees an obligation of a U.S. person, it "shall, under regulations prescribed by the Secretary, be considered as

holding [the] obligation."[4] § 956(d). Thus, if a CFC loans money to its U.S. affiliate, or guarantees a loan by another party to its U.S. affiliate, the CFC has invested in U.S. property, and its U.S. shareholders must include in income certain amounts of the CFC's earnings.[5]

Under § 956(a), the amount to be included in the U.S. shareholder's income is the shareholder's pro rata share of the lesser of (i) the average amount (on a quarterly basis) of U.S. property held by the CFC during the taxable year or (ii) the CFC's applicable earnings (as defined in § 956(b)). Section 956(a) generally provides that the amount of U.S. property to be taken into account for this purpose is the property's "adjusted basis." Ordinarily, a lender takes a basis in a loan equal to the unpaid principal. (Op/JA34.) Thus, for example, if the CFC lends $1,000 to a U.S. affiliate (or guarantees such a loan), and thereby holds (or is deemed to hold) a U.S. obligation equal to $1,000,

[4] Section 956(c)(2) contains several exceptions for certain obligations held (or deemed held, § 956(d)) by a CFC. None apply here.

[5] Earnings taxed to U.S. shareholders under § 951 are not taxed a second time when later distributed by the CFC to the U.S. shareholder as actual dividends. § 959.

the CFC's U.S. shareholder must include in its income the CFC's applicable earnings up to $1,000.

Section 956 does not inquire into the reasons for the CFC's U.S. investments or whether (and to what extent) the U.S. shareholder actually benefits from that investment. Rather, if a CFC invests in one of the four categories listed in § 956(c), or guarantees or pledges a U.S. obligation, § 956(d), it is deemed to have repatriated its earnings up to the amount of the investment. § 956(a).

In 1963, the year after Congress enacted Subpart F, Treasury proposed regulations to address newly enacted § 956. (JA417-505, Administrative Record.) As pertinent here, the proposed regulations addressed the treatment of CFC guarantees as U.S. investments and the amount of the resulting investment.

With regard to the treatment of guarantees, the proposed regulations adopted a general rule and an exception for conduit-financing arrangements. The proposed general rule mirrored the language of § 956(d), and provided that "any obligation … of a United States person … with respect to which a [CFC] is a pledgor or guarantor shall be considered for purposes of section 956(a) [and the related

regulatory provision] to be United States property held by such [CFC]." (JA490, Administrative Record (Prop. Reg. § 1.956-2(c)(1)).)

With regard to the amount of the CFC's U.S. investment due to loans or guarantees of loans, the proposed regulations similarly mirrored the statutory language. For loans, the amount was the CFC's "adjusted basis" in the loan — that is, the unpaid principal amount of the loan. (Op/34; JA479, Administrative Record (Prop. Reg. § 1.956-1(e)(1)).) For guarantors (which, under § 956(d), are deemed to hold loans), the amount was the "unpaid principal amount … of the obligation with respect to which the [CFC] is a … guarantor." (JA480, Administrative Record (Prop. Reg. § 1.956-1(e)(2)).)

Treasury received several comments in response to the proposed regulations, and held a public hearing in June 1963. (JA384-385, Administrative Record.) None of the comments raised concerns about the guarantee rules in proposed Reg. §§ 1.956-2(c)(1), 1.956-1(e)(2). (Op/JA22; JA319-386, Administrative Record.) Only one commentator made a suggestion regarding guarantees; the American Bar Association suggested that the exception for conduit arrangements in proposed Reg. § 1.956-2(c)(2) be broadened. (JA337-338, Administrative Record.)

In 1964, after considering all of the issues raised by the comments, Treasury promulgated the final regulations. (JA387-388, Administrative Record.) The preamble to the final regulations emphasized that they were designed to conform Treasury's income-tax regulations to newly enacted § 956. (JA387, Administrative Record.) Sections 1.956-2(c)(1) and 1.956-1(e)(2) were adopted substantially unchanged from the proposed regulations. (Op/JA23.) The exception for conduit-financing arrangements (now codified at Reg. § 1.956-2(c)(4)) was revised and broadened. (*Id.*)

C. SIHP and its CFCs

During the tax years at issue (2007-2008), SIHP was a Delaware partnership owned (through various S corporations) by five individual taxpayers. (JA115-124, Stipulation.) SIHP, in turn, owned 100% of the stock of two CFCs: (i) SIHL (later reorganized as SEHL, collectively SIHL/SEHL), an Irish corporation, and (ii) STS, a Cayman Islands corporation. (JA87-94, Stipulation.) SIHP also has a number of U.S. affiliates, including (as relevant here) SIG. (JA85-86, Stipulation.) The parties agree that SIG is a U.S. person, SIHL/SEHL and STS are CFCs,

and SIHP is their U.S. shareholder within the meaning of Subpart F. (JA85-86, 90, 94, Stipulation.)

During 2007-2008, SIHP and its U.S. affiliates invested in various U.S. financial products. (JA86, Stipulation.) In October 2007, one of SIHP's U.S. affiliates, SIG, borrowed $1.5 billion from Merrill Lynch (SIG-Notes). (JA95, Stipulation.) The SIG-Notes were guaranteed by SIHP's affiliates, including its two CFCs, SIHL/SEHL and STS. (JA97, Stipulation.)

D. Tax Court proceedings

The Commissioner determined that (i) SIHP had income inclusions under § 951(a)(1)(B) for 2007-2008 because its CFCs invested in U.S. property by guaranteeing the SIG-Notes, and (ii) that such inclusions did not qualify as dividends for purposes of § 1(h)(11)'s preferential tax rates. The CFCs' applicable earnings during 2007-2008 ($380 million) were far less than the $1.5 billion loan. (JA109-110, Stipulation.) Accordingly, the total amount included in SIHP's income was $380 million. (*Id.*)

SIHP filed a petition in the Tax Court, seeking review of both determinations by the Commissioner. (Op/JA5.) The parties cross-

moved for summary judgment. The Tax Court granted the Commissioner's motion and denied SIHP's cross-motion, finding that all facts material to the court's disposition of the motions were drawn from the parties' stipulations and were not in dispute. (Op/JA7.)

1. Income inclusions

The Tax Court first determined that SIHP must include in income the CFCs' applicable earnings for the tax years at issue (2007-2008). Under Reg. §§ 1.956-2(c)(1), 1.956-1(e)(2), if a CFC guarantees an obligation of a U.S. person, it is considered to hold that obligation, and a U.S. shareholder must include in its income the CFC's previously untaxed applicable earnings to the extent that they are less than the unpaid principal. Applying that law to the stipulated record, the court upheld the Commissioner's income inclusions because (i) SIHP's CFCs guaranteed obligations (the SIG-Notes) of a U.S. person (SIG), and (ii) the CFCs' applicable earnings were $380 million for 2007-2008. (Op/JA17-18.)

The Tax Court rejected SIHP's argument that the regulations were invalid. The court concluded that the administrative record reflects that Treasury complied with the APA's procedural

requirements when it promulgated the rules at issue (Op/JA26) and that Treasury's rationale for the rules could "'reasonably be discerned'" (Op/JA33). As the court explained, Treasury's regulations "adhere[ ] to the text of the statute," evidencing Treasury's intent "to implement the clear wording of the statute" by "equat[ing] the treatment" of guarantees with the treatment of loans "under the statute." (Op/JA33-34.) The court rejected SIHP's contention that Treasury should have considered a list of factors that it deemed pertinent to the guarantee rules, concluding that neither the statute nor the legislative history required "an on-the-record consideration of any particular factors," including what SIHP termed the "economic realities." (Op/JA31-32.)

The Tax Court also determined that Treasury's regulations were a reasonable interpretation of the statute that was entitled to *Chevron* deference. (Op/JA37-46.) It rejected SIHP's argument that § 956 is limited to "investments in U.S. property that repatriate earnings" and thereby requires a facts-and-circumstances analysis to determine whether any given guarantee actually repatriated earnings to the U.S. shareholder. (Op/JA40.) As the court explained, "nothing in the statute or its legislative history suggests that Congress expected Treasury to

craft ad hoc exceptions based on some sort of facts-and-circumstances test." (Op/JA42.)

In concluding that Treasury's interpretation of § 956 was reasonable, the Tax Court observed that Congress has never overruled Treasury's interpretation by amending § 956(d), although it has amended § 956 since 1962. (Op/JA42-43 (citing statutory amendments).) The court further observed that "Congress' decision to leave the terms of section 956(d) unchanged may reflect its understanding that a CFC ordinarily would not be directed by its shareholders to provide a guaranty unless the guaranty was necessary and of value to the borrower and the shareholders." (Op/JA43.)

Finally, the Tax Court rejected SIHP's reliance on affidavits from its officers that purported to demonstrate the reasons for, and value of, the guarantees, holding that such evidence was legally irrelevant. (Op/JA46-51.) As the court explained, "[n]either section 956(d) nor the regulations inquire into the relative importance that a creditor attaches to a guaranty" or the "guarantor's precise financial condition." (Op/JA47-48.)

2. Applicable tax rate

The Tax Court further determined that SIHP's income inclusions attributable to SIHL/SEHL's guarantee were properly taxed as ordinary income (as the Commissioner argued) rather than at the lower rate applicable to "qualified dividend income" under § 1(h)(11) (as SIHP argued).[6] (Op/JA51-56.) In so ruling, the court relied on an earlier Tax Court decision, affirmed by the Fifth Circuit, which held that income inclusions under § 951(a)(1)(B) are not "dividends" for purposes of § 1(h)(11).

SUMMARY OF ARGUMENT

This case involves laws designed to limit tax deferral by U.S. taxpayers who control foreign corporations. Pursuant to this anti-deferral regime, if a CFC invests in U.S. property, its U.S. shareholders must include earnings associated with that investment in their U.S. income. §§ 951(a)(1)(B), 956. Congress provided that when a CFC guarantees a loan of a U.S. affiliate, it has invested in U.S. property, thus triggering U.S. taxation for the CFC's U.S. shareholders on the

[6] The parties agreed that SIHP's income inclusions attributable to STS's guarantee did not qualify under § 1(h)(11). (Op/JA52.)

CFC's earnings, even though those earnings are retained and not distributed as dividends to the U.S. shareholders. § 956(d). Treasury has implemented § 956(d) by adopting categorical rules that generally treat any guarantee as a U.S. investment, without regard to its particular purpose or other factual circumstances.

In this case, two CFCs guaranteed a $1.5 billion loan for a U.S. affiliate of their U.S. shareholder (SIHP). Applying § 956(d) and the related regulations, the Commissioner determined that the guarantees were U.S. investments, and that, accordingly, SIHP was required to include the applicable earnings of the CFCs ($380 million) in its income. It further determined that the income inclusions were not eligible for § 1(h)(11)'s preferential tax rates for "qualified dividend income." Both determinations were affirmed by the Tax Court.

1. The Tax Court correctly determined that the CFCs' guarantees triggered the income inclusion for SIHP. SIHP's attempt to avoid the tax consequences of its guarantee transaction lack merit. The regulations at issue — promulgated in 1964 — are substantively and procedurally valid. They track the clear language of § 956 and provide bright-line, administrable rules that taxpayers have followed — with

essentially no litigation — for over half a century. Moreover, Congress has never questioned Treasury's construction of § 956(d), despite the passage of over 50 years and multiple amendments to § 956. Although SIHP contends that the economic reality of its transaction does not merit taxation, binding authority precludes it from escaping the tax consequences that flow from the transaction's form.

2. The Tax Court also correctly determined that income inclusions under § 951(a)(1)(B) do not qualify for § 1(h)(11)'s preferential tax rates, as the Fifth Circuit has also held. Section 1(h)(11) is limited to "dividends," and § 951(a)(1)(B) inclusions are not dividends (actual or constructive). SIHP's argument to the contrary conflicts with § 1(h)(11)'s text, its history, and other provisions in the Code. It also conflicts with precedential agency guidance that Congress has acknowledged but has not altered. Again, SIHP's attempt to avoid the tax consequences that flow from how it structured its transaction is unavailing. And it has provided no reason for this Court to go into conflict with its sister circuit.

ARGUMENT

I

The Tax Court correctly determined that SIHP was required to include in its income the earnings of its CFCs due to their guarantees of a loan to SIHP's U.S. affiliate

Standard of review

Grants of summary judgment are reviewed *de novo*.

A. Introduction

This case involves a U.S. shareholder that directed its wholly owned CFCs to guarantee a $1.5 billion loan to a U.S. affiliate. Under the clear, categorical rules enacted by Congress and Treasury over 50 years ago, those guarantees are treated as investments in U.S. property under Subpart F of the Code and, as such, require SIHP to include in income the applicable earnings of the guaranteeing CFCs ($380 million).

When it enacted Subpart F, Congress sought to ensure that the earnings of CFCs that were used to invest in U.S. property (as defined in § 956) were subject to U.S. tax, even though the earnings were "undistributed" to the U.S. shareholder. S. Rep. 87-1881, at 80. Section 956(c) broadly defines U.S. property (with limited exceptions

inapplicable here) as (i) "tangible property" located in the United States, (ii) "stock" of U.S. corporations, (iii) "obligation[s]" of a U.S. person, and (iv) the right to "use" certain intangible property in the United States. If the CFC makes one of these investments, the U.S. shareholder is taxed directly on the CFC's applicable earnings in an amount up to the CFC's "adjusted basis" in the U.S. property.[7] §§ 951(a)(1)(B), 956(a).

In keeping with the remedial nature of the legislation, § 956(c)'s definition of U.S. property is "categorical," as SIHP acknowledges (Br.8). Section 956 does not inquire into the purpose of the CFC's investment in U.S. property or its value to the U.S. shareholder; if the CFC holds, directly or indirectly, any U.S. property as defined in § 956(c), then its U.S. shareholders must include the lesser of (i) the average amount (on a quarterly basis) of U.S. property held by the CFC during the taxable year or (ii) the CFC's applicable earnings (as defined in § 956(b)). § 956(a).

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[7] Technically, U.S. shareholders are required to include in income their pro rata share of the CFC's investment in U.S. property. Because SIHP owns 100% of its CFCs' stock, it must include in income 100% of their investment, to the extent of their applicable earnings.

Section 956 also provides a special rule for one type of U.S. property listed in § 956(c) — obligations. Section 956(d) provides as follows:

> For purposes of subsection (a), a [CFC] shall, under regulations prescribed by the Secretary, be considered as holding an obligation of a United States person if such [CFC] is a pledgor or guarantor of such obligation.

As is the case with § 956(c), the rules under § 956(d) are categorical. With a limited exception inapplicable here, guarantors of an obligation of U.S. persons are treated as holding that obligation. § 956(d); Reg. § 1.956-2(c)(1). And, because the CFC is treated as holding an obligation if it guarantees the obligation, the amount of the deemed U.S. investment is equal to the amount of the unpaid principal at the time of the guarantee. § 956(a); Reg. § 1.956-1(e)(2). As with the underlying obligation itself, the purpose or value of the guarantee to the U.S. shareholder is irrelevant.

Section 956(d) provides an important backstop to § 956(c)'s treatment of obligations. Under § 956(c)(1)(C), any loan from a CFC to a U.S. affiliate is an investment in U.S. property that is includable in income under § 951(a)(1)(B), unless one of the narrow exceptions set out in § 956(c)(2) applies. That tax consequence could easily be avoided if

the foreign subsidiary were able to guarantee an independent loan to its U.S. affiliate without triggering § 951(a)(1)(B). For example, instead of borrowing funds directly from the CFC, the U.S. affiliate could simply induce an outside lender to extend the loan by directing its CFC to guarantee the loan. To eliminate that potential for abuse, § 956(d) categorically provides that if the CFC is a guarantor of an obligation of a U.S. person, then the CFC is deemed to hold the obligation itself.

These bright-lines rules have been in place for over 50 years and have provided clear guidance to U.S. taxpayers contemplating financial arrangements involving their CFCs. If taxpayers want to avoid paying tax on their CFC's retained earnings under § 956(d), they simply avoid having the CFC guarantee loans to U.S. affiliates. If they want to have the CFC guarantee the loan — for whatever reason — then they pay the tax due on the CFC's earnings, up to the amount of the guaranteed loan. As the Tax Court logically observed: "If a guaranty by a CFC is unnecessary, then it need not be made; and the application and effects of the regulations under section 956(d) will be avoided." (Op/JA50.) Because the rules are so clear, and thus "lend themselves to easy tax

planning," there has been almost no litigation involving the CFC-guarantee rules since they were promulgated in 1964. (Op/JA51.)

Moreover, during the past 50 years, Congress has amended § 956, adding and removing exceptions over time to "reflect its evolving conception of what should or should not require an income inclusion as an investment of earnings in United States property." (Op/JA42-43.) It has never, however, amended, or provided exceptions to, § 956(d)'s categorical rule regarding guarantees. (Op/JA23-24, 43.)

Against this settled legal landscape, SIHP seeks a sea change. It challenges Treasury's CFC-guarantee rules as substantively and procedurally invalid and asks this Court to rewrite the rules by inserting into the established law a new facts-and-circumstances test that neither Congress nor Treasury deemed appropriate. As demonstrated below, neither the statute, its history, nor administrative guidance permits SIHP's self-serving attempt to revise the rules in a manner that allows it to escape current taxation on its CFCs' investment in U.S. property. Treasury's CFC-guarantee regulations reasonably interpret § 956 (*see*, below, § B) and were adequately explained when promulgated in 1964 (*see*, below, § C). And, even if

these long-standing regulations were somehow invalid — which they are not — the income inclusions at issue would nevertheless be required under the statute itself (*see*, below, § D).

Before turning to those arguments, two points bear emphasizing. First, the regulations have provided clear, categorical rules for over 50 years, and during that time period, all other taxpayers in SIHP's circumstance have been required to either pay the tax that follows from § 956(d) and the related regulations, or avoid having CFCs guarantee U.S. obligations. *See Hildebrand v. Commissioner*, 683 F.2d 57, 59 (3d Cir. 1982) ("It bears mentioning that other taxpayers who relied upon the plain meaning of the statute by not claiming a deduction lost what is sought here. From the standpoint of equality then, reliance on the clear language of the Code distributes unhappiness without discrimination."). Indeed, the charge that SIHP inaccurately ascribes to the Government actually describes its endeavor in this litigation: SIHP seeks "to have it both ways" (Br.1). It wants to have its CFCs guarantee an obligation of its U.S. affiliate but, at the same time, continue to defer the tax on the CFCs' retained earnings. SIHP fails to

explain, however, why it should be entitled to avoid the clear CFC-guarantee rules that all other taxpayers have been required to follow.

Second, in interpreting the statutory language of § 956, it must be remembered that the ability of U.S. taxpayers to defer taxation on their CFCs' earnings is a "privilege." Rev. Rul. 76-125, 1976-1 C.B. 204; *see Heverly v. Commissioner*, 621 F.2d 1227, 1241 (3d Cir. 1980) (holding that "tax deferral" is "a matter of legislative grace, and that strict compliance with the statute is necessary regardless of our agreement or disagreement with the conditions imposed"). SIHP's attempt to avoid strict compliance with the CFC-guarantee rules conflicts with the basic tax principle that "[d]eferral[s] of income tax," as "exceptions to the normal income recognition rules[,] must be strictly construed." *Howard Hughes Co. v. Commissioner*, 142 T.C. 355, 383 (2014) (collecting cases), *aff'd*, 805 F.3d 175 (5th Cir. 2015).

B. Treasury's CFC-guarantee regulations are a reasonable interpretation of § 956

The primary issue in this appeal is whether § 956 permits the categorical rules for guarantees that Treasury promulgated in Reg. §§ 1.956-2(c)(1), 1.956-1(e)(2) (as the Commissioner argues and the Tax Court held) or whether § 956 requires Treasury to apply a facts-and-

circumstances test on an ad hoc basis (as SIHP contends). Section 956 does not directly address this "precise question" and therefore "the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984). If the construction is permissible, then the Court defers to it. *Id.* at 843-844. This basic principle of administrative law (referred to as *Chevron* deference) "appl[ies] with full force in the tax context." *Mayo Found. for Med. Educ. & Res. v. United States*, 562 U.S. 44, 55-56 (2011); *see Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162, 171 (3d Cir. 2008) (deferring to Treasury's "permissible construction").

The Tax Court correctly determined that it "is not manifestly contrary to the statute or unreasonable that the agency would choose a broad baseline rule for pledges and guaranties as opposed to a less administrable case-by-case approach." (Op/JA45.) In matters of tax law, bright-line, "categorical" rules are upheld so long as they are not "arbitrary or capricious in substance, or manifestly contrary to the statute." *Mayo*, 562 U.S. at 53, 58-59 (deferring to categorical Treasury regulation and rejecting argument that Treasury "should be required to

engage in a case-by-case inquiry"); *see Swallows Holding*, 515 F.3d at 172 (rejecting challenge to categorical Treasury regulation and observing that "drawing this temporal line is a task properly within the powers and expertise of the IRS"); *Balestra v. United States*, 803 F.3d 1363, 1371 (Fed. Cir. 2015) (upholding Treasury regulation that was "workable, simple, and flexible," even though it did not account for critical "contingency").

As detailed below, nothing in the language of § 956 or its history precludes Treasury's adoption of categorical rules for guarantees. SIHP's arguments to the contrary — which are wholly unmoored from the statute's text or history — lack merit. By insisting that a fact-intensive, ad hoc test is required to implement § 956(d), SIHP would have this Court ignore that "[r]egulation, like legislation, often requires drawing lines." *Mayo*, 562 U.S. at 59. The regulations at issue here provide administrable, bright-line rules that track the language of the statute. Indeed, in describing its recommended approach to Subpart F, Treasury observed that "overly complex rules may create 'traps for the unwary,'" and "simple tax rules facilitate voluntary compliance and minimize administrative costs for taxpayers and government."

Treasury Dep't, *Deferral of Income Earned through U.S. CFCs* 84 (2000) (Treasury Report).

1. The regulations implement the plain language of § 956

In reviewing the reasonableness of a regulation, the "plain language of the statute" is of primary importance. *Helen Mining Co. v. Elliott*, 859 F.3d 226, 236-237 (3d Cir. 2017). Sections 1.956-2(c)(1) and 1.956-1(e)(2) of the Treasury regulations are reasonable interpretations of § 956 because they simply mirror the statutory language, as the Tax Court correctly concluded. (Op/JA33-34.) *See Nat'l Indus. Sand Ass'n v. Marshall*, 601 F.2d 689, 704 (3d Cir. 1979) (upholding "regulations [that] simply parrot the statutory" language and "do not exceed the scope of the statute").

The generally applicable rule in Reg. § 1.956-2(c)(1) follows naturally from the plain language of § 956(d). As set out above, § 956(d) provides (in relevant part) that a CFC "shall, under regulations prescribed by the Secretary, be considered as holding an obligation of a United States person if such [CFC] is a … guarantor of such obligation." Consistent with that plain language, the regulation provides (i) a general rule that is categorical and (ii) a limited exception that depends

on the transaction's facts. The categorical general rule provides that "any obligation … of a United States person … with respect to which a [CFC] is a pledgor or guarantor shall be considered for purposes of section 956(a) and paragraph (a) of this section to be United States property held by such [CFC]." Reg. § 1.956-2(c)(1) (omitting definitional references). The exception provides that the general rule does not apply for "certain conduit financing arrangements," and the applicability of the exception "depend[s] upon all the facts and circumstances." Reg. § 1.956-2(c)(4).[8]

Similarly, Reg. § 1.956-1(e)(2) — which addresses the amount of the guarantor-CFC's investment in U.S. property — follows naturally from the plain language of §§ 956(a), 956(d). Section 956(a) provides that "[t]he amount taken into account … shall be [the property's] adjusted basis … reduced by any liability to which the property is subject." The adjusted basis of an obligation generally equals the unpaid principal. (Op/JA34.) Section 956(d), in turn, treats a CFC's guarantee of an obligation as the "holding" of that obligation. Mirroring this statutory language, Reg. § 1.956-1(e)(2) provides that "the amount

[8] The parties agree that this exception is inapplicable here.

taken into account with respect to any … guarantee … shall be the unpaid principal amount … of the obligation."

As this comparison of the regulatory and statutory language demonstrates, Treasury's bright-line CFC-guarantee rules are not contrary to clear Congressional intent but are a permissible construction of § 956. Far from being arbitrary, "the regulations dealing with the treatment of pledges and guaranties, in substance, follow the statute." *Ludwig v. Commissioner*, 68 T.C. 979, 990 (1977), *nonacq. on other grounds*, AOD-1978-139. A rule that essentially repeats a statutory provision is plainly consistent with that statutory provision.

SIHP's proposed facts-and-circumstances evaluation of the guarantee is wholly absent from the statutory text. Rather, § 956 considers only three facts:

- whether a CFC holds (§ 956(c)), or is considered to hold (§ 956(d)), U.S. property,
- the amount of that property (§ 956(a)), and
- the extent of the CFC's applicable earnings (§ 956(a)&(b)).

In particular, § 956(d) contains no qualifiers as to when a guarantor should be treated as holding an obligation, and it does not limit Treasury's discretion to adopt a rule that extends to the full limits of the statute. Although § 956(d) authorizes Treasury to issue regulatory exceptions, and Treasury has done so for certain conduit arrangements, the text of the statute does not require *any* exception to § 956(d)'s general rule. Importantly, it does not contain the facts-and-circumstances test that SIHP attempts to graft into the statute to support its desired outcome. As the Tax Court correctly recognized, it was "not free to 'rewrite the statute' to [SIHP's] liking." *Nat'l Ass'n of Mfrs. v. Dep't of Def.*, 138 S. Ct. 617, 629 (2018).

Ignoring the actual language of § 956, SIHP contends (Br.18) that Congress has confined § 956 to situations where CFC earnings "are repatriated to the United States." That is not the language that Congress enacted. Actual repatriation is not the test for § 956; indeed, the term appears nowhere in the statute. Instead, § 956 lists certain U.S. investments that will trigger income inclusions — tangible property, stock, obligations, certain types of intangible property, and pledges/guarantees (which are treated as obligations). Congress has

deemed these defined investments to be "effective repatriation[s]" for U.S. tax purposes. S. Rep. 94-938, at 226. SIHP complains that "the section 956(d) regulations recharacterize *every* CFC guarantee as a direct loan" (Br.31). But SIHP's real complaint is with the statute itself; Section 956(d) provides that a guarantee is treated as a loan. And by adopting rules that mirror the categorical nature of the statutory language, Treasury has provided rules that are clear and predictable, allowing "easy tax planning." (Op/JA51.)

Given the regulations' adherence to the statutory language, SIHP's reliance (Br.26, 37) on cases rejecting agency decision-making that was "not supported by text" of the governing statute, *Judulang v. Holder*, 565 U.S. 42, 64 (2011), is misplaced. For example, in *Woodall v. Fed. Bureau of Prisons*, 432 F.3d 235, 249 (3d Cir. 2005), this Court held that the agency's regulations were unreasonable because the statute at issue provided that the agency "must consider several factors" and the regulations provided that "the agency may not consider those factors," resulting in an "unavoidable" conflict between the two. Here, in stark contrast, the statute does *not* require Treasury to consider *any* factors — let alone the factors that suit SIHP's desired

outcome. Unlike the regulations in *Woodall*, the regulations here "follow the statute." *Ludwig*, 68 T.C. at 990. SIHP has not cited — and our research has not uncovered — any case that has invalidated a regulation that actually follows the statutory language. Indeed, SIHP never comes to grips with the plain language of the statute, relying instead on its purported "purpose and structure" (Br.27-37). As demonstrated next, SIHP's reliance is misplaced.

2. Nothing in the legislative history precludes Treasury's categorical rules

"Absent legislative history to the contrary, we must presume that the legislative purpose is expressed by the ordinary meaning of the words used" in the statute. *Glenn Elec. Co. v. Donovan*, 755 F.2d 1028, 1033 (3d Cir. 1985). The ordinary meaning of the words used in § 956(d) evidences that Congress intended guarantees to generally be treated the same as obligations for purposes of §§ 951(a)(1)(B), 956.

Nothing in the legislative history is to the contrary. There is almost no discussion of guarantees in the Congressional reports to the Revenue Act of 1962. The House Report's only reference is to note that CFC guarantees of obligations of U.S. persons, like obligations of U.S. persons held by CFCs, "are considered property located in the United

States." H.R. Rep. 87-1447, at A99 (1962). The subsequent Senate and Conference Reports do not discuss guarantees. H.R. Rep. 87-2508 (1962); S. Rep. 87-1881. The Technical Explanation of the Bill attached to the Senate Report essentially repeats the language now found in § 956(d), noting that then-designated "Subsection (c) provides that a [CFC], under regulations by the Secretary of the Treasury or his delegate, is considered to hold an obligation of a United States person if it is a pledgor or guarantor of such obligation." *Id*. at 252.

In short, there is no hint in the legislative history — let alone an expression of clear intent that could override the statutory language — that Congress intended Treasury to eschew categorical rules for guarantees and adopt the facts-and-circumstances test proposed by SIHP. Nothing in the history directs Treasury to treat guarantees differently than loans (Br.28-29) by making fact-intensive, ad hoc determinations regarding the subjective "value" and "repatriating effect" of guarantees (Br.19) rather than the bright-line rule applicable to loans. Nothing in the legislative history directs Treasury to determine the "actual value" of a given guarantee based on what SIHP terms "real-world factors" (Br.19).

SIHP's fanciful reference to the "features of guarantees that led Congress to grant Treasury regulatory authority in the first place" (Br.31) is baseless. There is no discussion in the legislative history about any features of guarantees or the regulatory authority granted in § 956(d). Indeed, the language granting this authority was drafted by Treasury itself, when it revised the original House bill for submission to the Senate. 108 Cong. Rec. 11010 (June 19, 1962). Moreover, during the debate over the revised bill, the guarantee rule was described in categorical terms without reference to Treasury's regulatory authority: "Section 956(c) … states that a [CFC] shall be considered 'as holding an obligation of a United States person if it is pledgor or guarantor of such obligation.'" 108 Cong. Rec. 18233 (Aug. 30, 1962).

Subsequent amendments to § 956 belie SIHP's contention that Treasury's 1964 regulations somehow thwart Congressional purpose. In 1976, Congress amended § 956 after reviewing the "present law" regarding § 956's implementation and concluded that "the types of property which are to be classified as U.S. investments for purposes" of taxing a U.S. shareholder for its CFC's undistributed earnings was "too broad" in certain respects. S. Rep. 94-938, at 225-226. Congress

narrowed the law by enacting a number of exceptions but did not alter Treasury's treatment of guarantees. In 1993, Congress again modified § 956 without altering Treasury's treatment of guarantees. *See* H.R. Rep. 103-213, at 642-643 (1993); H.R. Rep. 103-111, at 700-701 (1993). Although Congress discussed specific administrative guidance, it emphasized that it did not intend to "change [Treasury's] measurement of U.S. property." *Id.* at 701. Given this subsequent history, SIHP's legislative-purpose argument flies in the face of Congress's long acceptance of Treasury's categorical rules for guarantees. *See Williamson Shaft Contracting Co. v. Phillips*, 794 F.2d 865, 870 (3d Cir. 1986).

SIHP has cited nothing in the legislative history that provides a clear statement of Congressional intent that would preclude Treasury's categorical rules. Instead, it asks this Court to draw an inference (Br.27-30) based on (i) a reference to "dividends" and "repatriation" in a Congressional report, and (ii) the original bill. Neither bears the weight of SIHP's argument.

i. By enacting § 956, Congress sought "to prevent the repatriation of income to the United States" without taxation, H.R. Rep. 87-1447, at

58, and described CFC investments in U.S. property as "substantially the equivalent of a dividend" for U.S. shareholders, S. Rep. 87-1881, at 88. Those statements, however, do not mean — as SIHP suggests (Br.27-30) — that § 956 is limited to "actual" repatriations of income. Indeed, § 956 nowhere uses the term "repatriate." Rather, Congress more broadly sought to ensure that U.S. shareholders could not "use the earnings of controlled foreign corporations without payment of tax." S. Rep. 94-938, at 226. Thus, § 956 reaches broadly to "United States property held (directly or indirectly) by the [CFC]." § 956(a)(1)(A). Earnings put to such use are treated as "an effective repatriation … which should be taxed." S. Rep. 94-938, at 226. It is irrelevant under the statute whether earnings are actually repatriated; if a CFC loans money to its U.S. shareholder, § 956(c) applies even if the U.S. shareholder fully repays the loan (and without regard to whether or how the loan proceeds are even used). Section 956(d) backs up that rule by treating a guarantee of a loan the same as the loan itself. It is only by describing investments broadly that the statute and its implementing regulations can "prevent" the tax-free use of CFC earnings for U.S.-related purposes. H.R. Rep. 87-1447, at 58.

ii. SIHP's comparison of the original House version of the law and the enacted version (Br.29) does not further its case. The evolution of the statutory language does not reveal Congress's hidden design that Treasury adopt a fact-intensive, ad hoc approach to CFC guarantees. The original House version required U.S. shareholders to include in income earnings that their CFCs invested in all "nonqualified property," which was broadly defined to include "any money or other property … which is not qualified property." H.R. 10650, §§ 951, 953 (as introduced March 12, 1962). "Qualified property," in turn, was defined as (i) property "located outside the United States" that was "necessary" to the CFC's active business, and (ii) limited types of property "located in the United States." *Id.* at § 953(b)(2). The bill had a special provision for the "situs of certain property" that clarified that "an obligation of, or pledges and guarantees made with respect to obligations," of U.S. persons "shall be considered as property located in the United States." *Id.* at § 953(b)(4). Contrary to SIHP's characterization of the House bill, there was no "list" of CFC transactions that "automatically trigger U.S. tax" (Br.29); rather, there was a broad category of "nonqualified"

property — defined as all property that was not "qualified" — that triggered the tax.

That the bill was revised from this original broad category of "nonqualified" property to specifically identified categories of "U.S. property" in no way means that Congress intended to preclude Treasury from promulgating bright-line rules for any given category of U.S. property. SIHP's suggestion to the contrary is baseless, and ignores the fact that the revised bill that was ultimately enacted was drafted by Treasury. In submitting the proposed language to the Senate, Treasury represented to Congress that the revisions related to pledges, guarantees, and other investments in U.S. property were merely "technical changes." Draft of Statutory Language, with Accompanying Explanation, of Amendments Proposed by the Secretary of the Treasury, U.S. Senate Committee on Finance 2 (May 31, 1962). There is no hint in Treasury's explanation of the amendments that it proposed (and Congress ultimately enacted) that Treasury was precluded from adopting categorical rules. When the Joint Committee on Taxation later compared the House and Senate versions of the bill, it too agreed that "[b]oth versions tax in substantially the same manner … earnings

which are reinvested in the United States although not distributed to the U.S. shareholders" as dividends. *Summary of Senate Amendments to H.R. 10650* at 12 (Sept. 20, 1962).

Equally meritless is SIHP's related argument (Br.30-31) that categorical rules for guarantees are prohibited because Congress did not list guarantees in § 956(c) but provided for them separately in § 956(d). The reason for the separate listing is not as SIHP imagines. Section 956(c) lists types of "property." Guarantees — unlike obligations and the other items listed in § 956(c) — generally are not considered to be property; they are liabilities. Nor do they have an adjusted basis (for purposes of computing the amount of the CFC's investment in U.S. property). It is only through the separate construct set out in § 956(d), which *deems* a guarantor as holding U.S. property (*i.e.*, the related loan), that a guarantee is treated *as if it were* property. Thus, § 956's separate rule for guarantees is wholly compatible with Treasury's categorical rules, which — like the statute — treat guarantees as if they were loans.

3. SIHP's attempt to avoid the form of the transaction that it chose by focusing on its purported substance is unavailing

Unable to avoid the undisputed fact that its CFCs guaranteed an obligation of a U.S. affiliate, SIHP asks this Court to disregard the form of its transaction and direct the Tax Court to conduct a facts-and-circumstances analysis into whether there was a "repatriation in substance" (Br.42-46). SIHP's argument conflicts with binding precedent.

It is fundamental that a taxpayer, having chosen how to structure a transaction, may not renounce that chosen form to avoid the form's tax consequences. "[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, and may not enjoy the benefit of some other route he might have chosen to follow but did not." *Commissioner v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974) (citations omitted); *accord Boulware v. United States*, 552 U.S. 421, 429 n.7 (2008); *e.g., Strick Corp. v. United States*, 714 F.2d 1194, 1206 (3d Cir. 1983) ("The government has the right to claim that the form of a transaction should not be utilized to postpone

taxes that are otherwise due. The taxpayer does not have the like right to contend that the form that it has chosen should be ignored so that avoidance or postponement of the tax can be accomplished.").

To be sure, SIHP claims that it is not seeking to "recharacterize the guarantees as different hypothetical transactions." (Br.46, n.11.) Indeed, the CFCs' guarantees were guarantees in both form and substance, and SIHP does not argue otherwise.[9] (JA180-237.) Rather, SIHP argues that its guarantees should not have the tax consequences that Congress assigned to them — *i.e.*, income inclusion — because they did not amount to a "repatriation in substance." (Br.44-46.) But as explained above, that is not the legal test. Congress, in enacting § 956(d), decided that a guarantee is "enough" of a repatriation to warrant income inclusion. So the only relevant inquiry is whether the CFCs were "guarantors" within the meaning of § 956(d), and if they

[9] That the CFCs' money may not have been needed to secure the SIG-Notes (Br.44-45) does not convert the guarantees into something else. A mortgage is no less a mortgage merely because the homebuyer could have paid cash.

were (and both parties agree they were (Op/JA12; Br.14)), then the tax results are clear: income inclusion.[10]

SIHP's reliance on administrative rulings where the IRS invoked the substance-over-form doctrine is entirely misplaced. The substance-over-form doctrine allows the IRS to recharacterize the form of a transaction based on its true substance to ensure that tax laws are not improperly manipulated. *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). In the rulings cited by SIHP, taxpayers designed their transactions as something *other* than a guarantee or loan to avoid triggering income inclusion under § 956. In deciding whether the transaction should be recharacterized, the IRS correctly considered whether (among other things) there was an effective repatriation of CFC earnings. That inquiry helped to properly characterize the transaction so that its tax consequences could be determined. Here, however, there is no dispute as to the transaction's character: a

[10] It has "long" been understood by the "tax bar" that CFC guarantees result in income inclusion under §§ 951(a)(1)(B), 956, as SIHP conceded in its summary-judgment briefing. (Doc. 25 at 59-60.)

guarantee.[11] Moreover, the key ruling that SIHP relies on (Rev. Rul. 89-73) emphasizes that the Commissioner's examination of a transaction's substance does "not provide a taxpayer the right to compel the Internal Revenue Service to disregard the form of its transactions for Federal income tax purposes." Rev. Rul. 89-73, 1989-1 C.B. 258 (citing *Nat'l Alfalfa*).

In arguing for a repatriation-in-substance test, SIHP is really just arguing that it should not bear the tax consequences of its chosen form. But SIHP chose to structure its financing by having its CFCs each formally guarantee the SIG-Notes to the full extent of the loan.

That this case involves multiple guarantors provides no reason to allow SIHP to avoid the tax consequences of its transaction. In this regard, SIHP contends that the § 956(d) regulations "are particularly unreasonable" when applied to multiple guarantors because (in its

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[11] SIHP's reliance on the transaction's purported "economic reality" (Br.43) is misplaced. The economic reality is that the CFCs here are related parties that SIHP controls, and that relationship allows it to treat the CFCs' earnings as its own. Indeed, the tax deferral on which SIHP relies is itself a "legalistic" concept that ignores the economic reality that the CFCs have realized income on which their U.S. parent owes tax. Brumbaugh, Congressional Research Service, *U.S. Taxation of Overseas Investment & Income* 3 (Aug. 2002).

view) "no one guarantor can plausibly be viewed as making the entire amount of the loan available to the U.S. shareholder" (Br.31-32). That contention is baseless. If a lender requires two CFCs to guarantee a loan, then, at the very least, the lender has available to it the earnings of both CFCs. In that way, both CFCs have made available their earnings to the U.S. shareholder. In other words, if a lender requires $200 of foreign earnings to guarantee $100 of a U.S. loan, then the $200 of foreign earnings has, in fact, been made available to the U.S. shareholder, and the tax deferral normally applicable to that $200 of earnings ends.[12] Without access to those earnings, the U.S. shareholder could not have obtained the U.S. loan. The lender's motives for requiring access to earnings that exceed the loan amount (Br.42) are irrelevant.[13] Although this result may seem "strange" (Br.36), because

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[12] Taxing the earnings of two CFCs in connection with guarantees of a single obligation does not result in double taxation, only the ending of tax deferral for both CFCs.

[13] SIHP contends that Merrill Lynch required multiple guarantees for the SIG-Notes for reasons unrelated to repatriation (Br.42-43). Whether true or not, the relevant point remains that access to the earnings of SIHP's CFCs was granted to Merrill Lynch in exchange for the loan to SIHP's U.S. affiliate. Nothing more is required under §§ 951(a)(1)(B), 956 to trigger the income inclusions at issue.

one of the CFCs could have simply loaned $100 directly to the U.S. shareholder and thereby avoided income inclusion of the other $100, it is a predictable result that can easily be avoided. Of course, in this case, there is no such "strange" result because the CFCs' applicable earnings to be included in SIHP's income ($380 million) were far less than the amount of the loan that they guaranteed ($1.5 billion). (JA109-112, Stipulation.)

Because the Tax Court's income-inclusion determination is consistent with the plain language of the statute and regulations, there is no need for a remand, as SIHP suggests (Br.44-46). The multitude of factual issues raised by SIHP (Br.42-45) cannot alter the tax consequences of the undisputed fact that its CFCs guaranteed the loan of a U.S. person. Whether or not (i) the guarantee was necessary for credit purposes, (ii) the CFCs had the financial ability to satisfy the guaranteed liability, or (iii) the CFCs had a theoretical right of recovery against other guarantors, is wholly irrelevant. (Op/JA50.) *See Crestek, Inc. v. Commissioner*, No. 8285-13, 2017 WL 3209182, at *8-9 (T.Ct. July 27, 2017) (deeming irrelevant under § 956(d) taxpayer's contention that its CFC "guaranty was 'a meaningless gesture'" that "provided no

incremental security" for the U.S. obligation). Under §§ 951(a)(1)(B), 956, SIHP has income inclusions because its CFCs guaranteed the SIG-Notes. Everything else is just a distraction that the Tax Court correctly disregarded.

C. Treasury's regulations are procedurally valid

An agency's rulemaking is "procedurally" valid so long as the agency "follow[ed] the correct procedures in issuing the regulations" and provided "adequate reasons for its decisions." *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016). An agency's "explanation is clear enough" if its "'path may reasonably be discerned.'" *Id.* (citation omitted). Where (as here) the agency's rule does not reflect a "change in position," *id.* at 2126, less of an explanation is required. (Op/JA28-30.) *See Gardner v. Grandolsky*, 585 F.3d 786, 792 (3d Cir. 2009) (upholding regulation even though agency's "rationale was not explicit in the Federal Register notices").

The Treasury regulations implementing § 956 fully comply with all procedural requirements for rulemaking, as the Tax Court correctly determined. (Op/JA30-33.) As detailed above (pp. 6-8), in 1963, Treasury published proposed regulations, invited and reviewed public

comments, and held a public hearing. (Op/JA22.) In 1964, Treasury promulgated final regulations that took the written comments that it had received into consideration. (Op/JA22-23.) Together these steps satisfied Treasury's rulemaking obligations under the APA's notice-and-comment requirements. (Op/JA33.)

Treasury also adequately explained the reason for its rules. (Op/JA30-37.) When it published the proposed regulations to implement the newly enacted Subpart F, Treasury explained that it was doing so to "conform the Income Tax Regulations … to sections 955, 956, and 957(c)" of the Code. (JA417, Administrative Record.) Treasury reiterated that point in the preamble to the final regulations, adding that in conforming the regulations to the statute, it had taken into "consideration … all such relevant matter as was presented by interested persons regarding the rules proposed." (JA387-388, Administrative Record). That explanation aptly described the regulations at issue, which — in fact — mirror the statute and thereby conform the regulations to the Code.

There was no reason for Treasury to spell out "why it adopted a categorical rule" (Br.41). Neither the statute or its history, nor any

commentator suggested that Treasury should consider adopting a non-categorical rule. Treasury's desire for "simple tax rules[, which] facilitate voluntary compliance and minimize administrative costs for taxpayers and government," Treasury Report, above, at 84, is reflected in the language of the regulations themselves. *See Gardner*, 585 F.3d at 793 (holding that the "language of the regulation itself facially manifests" the agency's reasoning). Given that the regulations track the statute, Treasury's "'path may reasonably be discerned.'" *Encino*, 136 S. Ct. at 2125 (citation omitted).

Nor did Treasury ignore an "important aspect" of § 956(d) (Br.40) when it adopted categorical rules to implement that section. The "APA requires only that an agency 'demonstrate that it has considered the relevant factors brought to its attention by interested parties during the course of the rulemaking.'" *La. Forestry Ass'n v. Dep't of Labor*, 745 F.3d 653, 677 (3d Cir. 2014) (citation omitted). Treasury easily satisfied that standard here. It proposed its categorical rules in 1963 and, in response, not a single commentator questioned Treasury's categorical approach. (JA319-385, Administrative Record.) No commentator expressed concern about — or even mentioned — that the regulations

generally applied § 956(d) to all guarantees. (*Id.*) Nor did any commentator express concern about — or even mention — that the regulations determined the amount of property held by a guarantor based on the unpaid principal amount of the obligation. (*Id.*) Importantly, no commentator suggested that these bright-line rules went beyond the language or intent of the statute or suggested that Treasury adopt a facts-and-circumstances test rather than these bright-line rules. (*Id.*) And no commentator questioned how the bright-line rules would apply in the case of multiple guarantors of the same obligation. (*Id.*)

That an agency's explanation is brief does not mean that it is inadequate, as SIHP incorrectly suggests (Br.40-41). *See* 5 U.S.C. § 553(c) (requiring agencies to provide "concise general statement of [a rule's] basis and purpose"). Its reliance in this regard on *Good Fortune Shipping v. Commissioner*, 897 F.3d 256 (D.C. Cir. 2018), is misplaced. A simple explanation was insufficient there because — unlike here — the regulations effectively "rewr[o]te" the statute at issue.[14] *Id.* at 262-

[14] For similar reasons, the agency's rationale for the regulation analyzed in *Dominion Res., Inc. v. United States*, 681 F.3d 1313 (Fed.

263. Such a "regulatory amendment" was not justified by "only a single, undeveloped statement." *Id.* Here, there is no such re-writing and thus no need for a lengthy justification.

Nor is this a case in which the agency "has taken seemingly inconsistent positions." *Nat'l Parks Conservation Ass'n v. EPA*, 803 F.3d 151, 164 (3d Cir. 2015) (cited at Br.38). At no point has Treasury disregarded a CFC guarantee, or deemed it to be less than the outstanding loan amount, based on the guarantee's value (or lack thereof). That in 2015 — years after the transactions at issue — Treasury sought comments regarding whether to limit the "aggregate inclusions … to the unpaid principal amount of the obligation" in the case of multiple guaranteeing CFCs has no impact on the consistent approach Treasury took prior to or since that date. 81 Fed. Reg. 76497, 76503 (2016). In any event, any error in this regard would be harmless because SIHP would not have benefited under the approach that Treasury suggested that it may adopt in the future. Here, the CFCs'

Cir. 2012), was deemed inadequate. In sharp contrast to the regulations here, the regulation there "contradicts" the specific rule "that Congress intended the statute to implement." *Id.* at 1317.

aggregate inclusions ($380 million) are far less than the unpaid principal amount of the loan ($1.5 billion).

D. Alternatively, the income inclusions at issue are required by § 956(d)

Even if the regulations were invalid, or had never been promulgated in the first instance, the statutory language of § 956(d) is still operative and supports the income inclusions here. Unless the Code expressly conditions its operation on the promulgation of regulations, "the absence of regulations is not an acceptable basis for refusing to apply the substantive provisions of a section of the Internal Revenue Code." *Int'l Multifoods Corp. v. Commissioner*, 108 T.C. 579, 587 (1997); *see United States v. Microsoft Corp.*, 154 F. Supp. 3d 1134, 1143 (W.D. Wash. 2015) (holding that "[b]ecause Microsoft has failed to prove that the IRS lacked this authority under statute, the validity or invalidity of the temporary regulation is moot"); *Estate of Neumann v. Commissioner*, 106 T.C. 216, 221-222 (1996) (holding that the statute was self-executing, making it unnecessary to address the "alleged failure of the Secretary to comply with the [APA]" when promulgating related regulations).

The language of § 956(d) — "under regulations prescribed by the Secretary" — indicates that the statute is self-executing, as courts interpreting identical language have held. For example, in *Temsco Helicopters, Inc. v. United States*, 409 F. App'x 64, 67 (9th Cir. 2010), the Ninth Circuit held that a carrier was liable for tax under § 4263(c), which provides that the carrier "shall pay" the tax "under regulations prescribed by the Secretary," even though "the Secretary never implemented the related regulations." As the court explained, the statute contained no "explicit language" that conditioned the enforcement of the statute on the promulgation of regulations. *Id.* *Accord Pittway Corp. v. United States*, 102 F.3d 932, 935-936 (7th Cir. 1996) (holding that taxpayer's use of butane was taxable under § 4662(b)(1), which provides that "[u]nder regulations prescribed by the Secretary, methane or butane shall be treated as a taxable chemical …," despite the absence of regulations). In contrast, if a statute provides that it "shall apply only to the extent provided in regulations prescribed by the Secretary," then the issuance of regulations determines whether it applies and, in that circumstance, the statute is considered to be non-self-executing. *Alexander v. Commissioner*, 95 T.C. 467, 473 (1990). If

Congress had intended the issuance of regulations to be a precondition to the operability of § 956(d), it would have used language such as "to the extent provided in regulations, guarantors should be deemed to hold obligations." It did not do so. Instead, it merely authorized Treasury to issue regulations in furtherance of the announced policy of income inclusion regarding guarantees.

Section 956(d)'s legislative history confirms our reading of the statute's plain text. According to that history, § 956(d) (then set out in § 956(c)) "states that a [CFC] shall be considered 'as holding an obligation of a United States person if it is a pledgor or guarantor of such obligation.'" 108 Cong. Rec. 18233 (Aug. 30, 1962). In summarizing § 956(d), the statutory reference to Treasury regulations was disregarded altogether, and there is no hint that Congress understood that § 956(d)'s operation was contingent on the promulgation of regulations.

Section 956 itself provides clear and enforceable rules. As the Tax Court has held, "Section 956(d) provides that a CFC shall be considered as holding an obligation of a United States person if the CFC 'is a pledger or guarantor of such obligation.'" *Crestek*, 2017 WL 3209182, at

*9. And § 956(a) provides an equally workable rule regarding the amount to be included in income for such deemed obligations; the amount included is the adjusted basis in the obligation the CFC is deemed to hold. As the Tax Court determined — and SIHP does not dispute — lenders ordinarily take a basis in a loan equal to the unpaid principal. (Op/JA34.)

Moreover, even if Treasury's guarantee regulations are procedurally deficient, they reflect Treasury's long-standing interpretation of § 956(d). That unwavering "'administrative practice'" — established over 50 years ago — is itself entitled to "deference." *Conn. Gen. Life Ins. Co. v. Commissioner*, 177 F.3d 136, 143 (3d Cir. 1999) (citation omitted).

The Commissioner did not raise this argument in the Tax Court.[15] Nevertheless, the argument should be addressed, if this Court

[15] In the Tax Court, SIHP argued that § 956(d) was not self-executing, and, in response, the Commissioner contended that SIHP's argument was "a red herring" because the regulations (finalized shortly after the statute's effective date) were valid and reasonable. (Doc. 34 at 16 n.6.) Because the court agreed with the Commissioner that the regulations were valid and reasonable, it did not have to decide whether the statute was self-executing, noting only that the Commissioner had not disputed the issue. (Op/JA19.)

invalidates the regulations, given that the case involves the "exceptional circumstances" of a taxpayer seeking to void a critical component of a statutory anti-deferral provision based on the purported invalidity of 54-year old regulations. *Tri–M Group, LLC v. Sharp*, 638 F.3d 406, 416 (3d Cir. 2011); *see also Dandridge v. Williams*, 397 U.S. 471, 475 n.6 (1970).

II

The Tax Court correctly determined that SIHP's income inclusions do not qualify for § 1(h)(11)'s preferential tax rates

A. Introduction

The second issue in this appeal is whether SIHP's income inclusions qualify for § 1(h)(11)'s preferential tax rates. Enacted in 2003, § 1(h)(11) imposes tax at preferential rates on "qualified dividend income," which is defined as "dividends received during the taxable year from" domestic corporations and "qualified foreign corporations." § 1(h)(11)(B)(i). It is undisputed that STS is not a qualified foreign corporation but that SIHL/SEHL is. (Op/JA52.) The sole question is whether SIHP's income inclusions related to SIHL/SEHL's undistributed earnings invested in U.S. property constituted "qualified

dividend income" within the meaning of § 1(h)(11). As demonstrated below, the Tax Court correctly answered that question in the negative.

B. Income inclusions under § 951(a)(1)(B) are not dividends and therefore are not eligible for § 1(h)(11)'s preferential tax rates for qualified dividends

The Tax Court's determination that income inclusions under § 951(a)(1)(B) do not qualify for § 1(h)(11)'s preferential tax rates is consistent with every other court that has addressed whether such inclusions are dividends. *See Rodriguez v. Commissioner*, 722 F.3d 306, 309 (5th Cir. 2013) (holding that § 951(a)(1)(B) inclusions "do not constitute qualified dividend income" because they "involve no distribution or change in ownership"), *aff'g* 137 T.C. 174 (2011) (same); *Smith v. Commissioner*, No. 14900-15, 2018 WL 4490923, at *19 (T.Ct. Sept. 18, 2018) (holding that "section 956 inclusions were not 'constructive distributions'"); *Principal Life Ins. Co. v. United States*, 120 Fed. Cl. 41, 43 n.5 (2015) (observing that "Section 951 inclusions do not constitute actual dividends because actual dividends require a distribution by a corporation and receipt by the shareholder; there must be a change in ownership of something of value"); *see also* Bittker & Eustice, *Federal Income Taxation of Corporations & Shareholders*

¶15.61[3] & n.614, 1999 WL 516699 (2018) (observing that income included under § 951 "is not a 'dividend' to the shareholders" and therefore does not "qualify" for the "lower rates available under § 1(h)(11)"); 12 *Mertens Law of Federal Income Taxation* § 45E:160 (2018) (observing that because "[i]nclusions under Section 951 are not treated as dividends," they "are taxed at ordinary income rates, rather than at [§ 1(h)(11)'s] preferential income tax rates").

This uniform view is supported by (i) the plain language of § 1(h)(11) and its purpose, (ii) other statutory provisions, and (iii) long-standing precedential agency guidance. SIHP's arguments to the contrary lack merit and provide no reason for this Court to go into conflict with the Fifth Circuit.

1. Language and purpose of § 1(h)(11)

The plain language of the Code precludes SIHP's § 951(a)(1)(B) income inclusions from qualifying for the preferential tax rates. In order to be "qualified dividend income" for purpose of § 1(h)(11)'s preferential rates, an item of income must be a "dividend." (Op/JA53.) The term "dividend" is defined as a "*distribution* of property made by a corporation *to* its shareholders" "out of its earnings and profits."

§ 316(a) (emphasis added). In the absence of a special rule, there can be no dividend without a distribution, and a distribution cannot occur without a "change in ownership of something of value." *Rodriguez*, 722 F.3d at 309. It is undisputed that there is "no special rule or qualification to treat a section 951 inclusion as a dividend for purposes of section 1(h)(11)." *Rodriguez*, 137 T.C. at 177.

Section 951(a)(1)(B) involves "no transfer" of ownership from the CFC to the U.S. shareholder. *Rodriguez*, 722 F.3d at 310. The CFC — not the U.S. shareholder — owns the U.S. property. And the CFC — not the U.S. shareholder — remains liable for U.S. tax on any income generated by that U.S. property. § 881(a). Although the CFC's investment is *deemed* to repatriate earnings to the United States, it does not *actually* repatriate earnings to the U.S. shareholder. The CFC continues to own the U.S. property and retains its earnings until it provides "actual distributions" to its U.S. shareholder. § 959(d), (f)(2). Indeed, §§ 951, 956 were enacted precisely to address instances where CFCs retained their earnings instead of distributing them to their U.S. shareholders through dividends. *See* S. Rep. 87-1881, at 80. Because no actual distribution of property occurs in the case of a § 951(a)(1)(B)

inclusion, the Tax Court correctly concluded that such an item is not a dividend for purposes of § 1(h)(11).[16]

The Tax Court's interpretation of § 1(h)(11) is also fully consistent with its purpose. Congress enacted § 1(h)(11) "to remove a perceived disincentive for corporations to pay out earnings as dividends instead of retaining and reinvesting them." *Rodriguez*, 137 T.C. at 181. Because § 951(a)(1)(B) inclusions "represent earnings that CFCs have retained and reinvested in U.S. property instead of paying them out as dividends, characterizing these amounts as qualified dividend income would not appear to further the stated legislative purpose." *Id.* at 181-182. On the contrary, to treat § 951(a)(1)(B) inclusions as qualified dividends eligible for preferential tax rates, even though they are — by definition — undistributed amounts of corporate earnings, would contravene the intent of Congress in enacting § 1(h)(11).

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[16] SIHP's assertion (Br.63-64) that its CFCs distributed their earnings by guaranteeing the SIG-Notes is baseless. Under § 956(d), the CFCs are treated as holding a type of U.S. investment (an obligation), not as distributing their earnings to SIHP or SIG. As the Tax Court correctly explained, in this case, "as in *Rodriguez*, no transfer of ownership from corporation to shareholder occurred with respect to any property." (Op/JA54.)

Critically, SIHP has not — and cannot — cite anything in the text or history of § 1(h)(11) evidencing that Congress intended § 951(a)(1)(B) inclusions to be deemed dividends for purposes of § 1(h)(11). *Cf.* § 306(a)(1)(D) (treating the disposition of certain stock as a "dividend" "[f]or purposes of Section 1(h)(11)"). Indeed, shortly after enacting § 1(h)(11), Congress enacted a dividends-received deduction for certain situations but stated that the deduction would *not* apply to "items that are not included in gross income as dividends, such as subpart F inclusions or deemed repatriations under section 956." H.R. Rep. 108-755, at 300, 302 (2004). As this history highlights, § 951(a)(1)(B) inclusions are *not* — as SIHP posits — "dividend income by [their] very nature" (Br.61).

2. Section 951(a)(1)(B) inclusions are not constructive dividends

Recognizing that § 951(a)(1)(B) inclusions are not actual dividends, SIHP contends (Br.49-54) that § 951(a)(1)(B) inclusions are "constructive" dividends and that § 1(h)(11)'s qualified-dividend-income rules apply to "constructive dividends." The predicate for that argument is incorrect. Section 951(a)(1)(B) inclusions are *not* constructive dividends. A constructive dividend involves "value passing

from a corporation to, or a specific benefit conferred by a corporation on, its shareholder without receiving equivalent value in return." Bittker & Eustice, above, ¶8.06[1]; *e.g., C.F. Mueller Co. v. Commissioner*, 479 F.2d 678, 683 (3d Cir. 1973) (observing that a "constructive dividend" requires a "diversion of corporate earnings and profits"). In sharp contrast, § 951(a)(1)(B) inclusions are *not* distributions of value and do *not* reduce earnings and profits. § 959(d). It is that distinction that removes these inclusions from the scope of § 1(h)(11)'s plain language and purpose, as explained above. Thus, whether constructive dividends can ever qualify for § 1(h)(11) — an issue of first impression that has not yet been decided by a court or addressed by the IRS in precedential guidance — it would not further SIHP's position here.

None of the cases cited by SIHP (Br.50-52) supports the proposition that § 951(a)(1)(B) inclusions *are* constructive dividends. To the contrary, the only cited cases addressing such inclusions support the Government's position. *See Smith*, 2018 WL 4490923, at *19 (holding that "section 956 inclusions were not 'constructive distributions'"); *Dougherty v. Commissioner*, 60 T.C. 917, 927, 930 (1973) (recognizing that § 951(a)(1)(B) inclusions "might well be

insufficient to justify taxation under the judicially created doctrine of constructive dividends," but observing that they were "something akin to a constructive dividend"). That § 951(a)(1)(B) "has the stated objective of treating a [CFC's] increase in earnings invested in U.S. property *as if it were* a dividend paid to the corporation's shareholders," *id*. at 926 (emphasis added), does not mean that such inclusions *are* dividends (actual or constructive), as the Tax Court correctly recognized (Op/JA55).

Nor does "the Code itself" refer to § 951(a)(1)(B) inclusions as constructive dividends, as SIHP contends (Br.53). SIHP observes that a statute-of-limitations provision (§ 6501(e)(1)(C)) applicable to all § 951(a) inclusions is entitled "[c]onstructive dividends." That title is inapt; as SIHP concedes (Br.61), § 951(a)(1)(A) inclusions (for CFC Subpart F income) are *not* constructive dividends and thus, even under SIHP's view, the heading is incorrect. It appears that the Code contains this incorrect heading as a holdover from an earlier version of § 6501(e)(1)(C), which applied to now-repealed § 551(b),[17] rather than

[17] Section 551 was repealed by the American Jobs Creation Act of 2004, P.L. 108-357, § 413(a)(1).

§ 951(a). Former § 551(b) provided that undistributed foreign-personal-holding-company income was includable "as a dividend" in the shareholder's gross income. It is the absence of similar language in § 951 that renders SIHP's argument untenable.

3. Other statutory provisions illustrate that Congress did not deem § 951 inclusions to be dividends for purposes of § 1(h)(11)

Reinforcing the Tax Court's determination is the fact that Congress has expressly provided elsewhere in the Code — but not in § 1(h)(11) — that § 951 inclusions should be treated as dividends for certain limited purposes. For example, § 851(b) provides that, in determining whether taxpayers qualify as a regulated investment company, their § 951(a)(1)(A) inclusions are "treated as dividends" in certain circumstances. Similarly, § 904(d)(3)(G) provides that, "[f]or purposes of this paragraph [regarding foreign-tax-credit-limitation rules], the term 'dividend' includes any amount included in gross income in section 951(a)(1)(B)." And former § 960(a)(1) provided that, for purposes of applying § 902's indirect-foreign-tax-credit rules, § 951(a) inclusions shall be treated "as if the amount so included were a

dividend paid."[18] *See also* § 964(e)(4)(iii). If Congress had wanted income inclusions under § 951(a) to be "treated as dividends" for purposes of § 1(h)(11), it would have so provided. (Op/JA55.) It did not do so.

If § 951 inclusions are deemed dividends at *all* events — as SIHP contends — then Congress's enactment of statutory provisions treating § 951 inclusions as *if* they were dividends for *specific* events would have been wholly unnecessary. These express, but limited, provisions that deem a § 951 inclusion as a dividend for certain purposes undermine SIHP's contention (Br.52) that its income inclusions should be treated as "deemed" or "constructive" dividends for purposes of § 1(h)(11). As the Fifth Circuit held in *Rodriguez*, "if all § 951 inclusions constituted qualified dividends" — as SIHP contends (Br.52-53) — "then statutory provisions specifically designating certain inclusions as dividends would amount to surplusage" contrary to well-established tenets of statutory construction. 722 F.3d at 311 (citing §§ 851(b), 904(d)(3)(G), and 960(a)(1)).

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[18] This language was eliminated in the 2017 Tax Cuts and Jobs Act, P.L. 115-97, § 14301(b)(1).

SIHP's efforts to minimize the significance of Congress's express treatment of § 951 inclusions as dividends in §§ 851(b), 904(d)(3)(G), and 960(a)(1) cannot withstand scrutiny. These provisions do not merely "clarify the treatment of section 951(a)(1)(A) inclusions" (Br.61). Section 904(d)(3)(G) expressly refers to "section 951(a)(1)(B)" and former § 960(a)(1) broadly applied to all "section 951(a)" inclusions, not just Subpart-F-income inclusions under § 951(a)(1)(A). Although § 851(b) addresses only inclusions under § 951(a)(1)(A), it is not so limited because (as SIHP suggests (Br.62)) "Congress understood" § 951(a)(1)(B) inclusions to be subject to dividend treatment; rather, § 851(b) addresses income inclusions that are actually "distribut[ed] out of the earnings and profits of the taxable year which are attributable to the amounts so included." If a CFC actually distributes to its U.S. shareholder amounts that it has invested in U.S. property during the same taxable year as the distribution, then that income would not be included in the shareholder's income under § 951(a)(1)(B) due to the coordination rules set out in § 959(f)(2).

Equally lacking merit is SIHP's contention that the "structure of subpart F" (Br.53-56) confirms that § 951(a)(1)(B) inclusions are

properly taxed as dividends. To the contrary, the "structure of section 956" indicates that investments in U.S. property do *not* constitute dividends. (Op/JA55-56.) As the Fifth Circuit explained, the "original version of § 956 specifically stated that Congress did not intend amounts calculated thereunder to constitute dividends." *Rodriguez*, 722 F.3d at 311. As enacted in 1962, § 956 calculated the amount of U.S. property held by a CFC by reference "'to the extent such amount *would have* constituted a dividend … *if* it had been distributed.'" *Id.* (quoting Revenue Act of 1962) (emphasis altered). Although this language was removed in 1993 when the related subpart was rewritten, the omission of the quoted language did not reveal Congress's intent to alter its treatment of § 951(a)(1)(B) inclusions as non-dividends. *Id.*

SIHP's attempt to shoehorn § 951(a)(1)(B) inclusions into § 1(h)(11) also overlooks the fact that Congress has expressly provided, outside the context of Subpart F, for the treatment of certain nondividend amounts as dividends or distributions. *E.g.*, §§ 302(a), 304(a), 305(c), 1248(a). For example, § 1248(a) treats gain from the disposition of CFC stock "as a dividend, to the extent of the [CFC's] earnings." The latter provision is particularly pertinent because §§ 951,

956, and 1248 were all enacted by the Revenue Act of 1962. "'[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'" *Russello v. United States*, 464 U.S. 16, 23 (1983) (citation omitted). It is wholly illogical to suggest that the same Congress that expressly provided for dividend treatment of CFC-stock-sale gains under § 1248 intended the same dividend treatment to apply to § 951 inclusions yet failed to make any provision therefor. That Congress did not include "as a dividend" in § 951(a), but did so in § 1248(a), is telling.

4. Precedential agency guidance makes clear that § 951 inclusions do not qualify for § 1(h)(11)'s preferential tax rates

To the extent that there is any doubt, long-standing precedential agency guidance makes clear that SIHP's income inclusions do not qualify for § 1(h)(11)'s preferential tax rates. The year after § 1(h)(11) was enacted, Treasury published Notice 2004-70, which advised taxpayers that "section 951(a)(1) inclusions are not dividends and therefore cannot constitute qualified dividend income" for "purposes of

section 1(h)(11)." 2004-2 C.B. 724, § 4. As this guidance explained, "[n]either section 951(a)(1) nor the corresponding regulations characterize a section 951(a)(1) inclusion as a dividend," unlike other Code provisions (discussed above) that expressly characterize "deemed inclusions" as "dividends." *Id*. The Notice further observed that the legislation that enacted § 1(h)(11) also modified § 306 so that certain stock dispositions would be treated as a "dividend" "[f]or purposes of section 1(h)(11)," *see* § 306(a)(1)(D), but did not so modify § 951(a). *Id*. at n.6.

Although not controlling, Notice 2004-70's reasonable interpretation of the Code is entitled to "deference." *Esden v. Bank of Boston*, 229 F.3d 154, 169 (2d Cir. 2000). Indeed, the Notice's detailed "guidance" was cited with apparent approval by the Joint Committee on Taxation in its post-enactment explanation of § 1(h)(11). *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS-5-05) at 25 n.44 (2005). And, during the intervening years, Congress has taken no step to overrule the Notice's guidance.

Rather than address the published guidance precisely on point (Notice 2004-70), SIHP points to several inapposite Treasury rulings

(Br.56-57). None address the issue in this appeal. And by setting out specific instances in which § 951(a)(1)(B) inclusions would be treated as dividends, the rulings thereby underline the fact that such inclusions generally are *not* treated as dividends; specific regulatory authority was required to deviate from the general rule. As Treasury explained when promulgating one of the regulations cited by SIHP, "section 951 inclusions and section 1293 inclusions are not treated as dividends except when expressly provided for." 78 Fed. Reg. 72394, 72418 (2013).

SIHP's reliance on various nonprecedential IRS rulings (Br.57-58) is also misplaced. First, these unauthoritative documents may not be cited as precedent. *See* § 6110(k)(3). Moreover, none address the question of whether § 951 inclusions are eligible for § 1(h)(11)'s preferential tax rates. As the Fifth Circuit explained in rejecting reliance on these "non-binding secondary sources," the pre-2003 rulings that "loosely" referred to § 951 inclusions as "dividends" are particularly irrelevant because "there was no tax advantage to classifying CFC-owned property as a dividend" prior to 2003. *Rodriguez*, 722 F.3d at 311-312.

Since 2004, taxpayers have known that if they want the earnings of their CFCs to qualify for § 1(h)(11)'s preferential tax rates, then they would need the CFCs to distribute their earnings to the U.S. shareholders as dividends rather than engage in activity that would subject the undistributed earnings to § 951. Far from being "arbitrary" or "irrational" (Br.47-48), this outcome implements the language and purpose of § 1(h)(11). Section 1(h)(11) applies to earnings that have been *distributed* to a U.S. shareholder; Section 951, in contrast, applies to earnings that have been *retained* by a CFC.[19] The outcome here reflects the "economic reality" (Br.50) that SIHL/SEHL retained the earnings during 2007-2008. Although SIHP evidently regrets having structured its transactions "in the wrong order" (Br.48) by concededly allowing its CFCs to guarantee the SIG-Notes before distributing their earnings years later, it must face the same consequences that all other taxpayers with similarly structured transactions have faced. SIHP

[19] That a CFC's investment in U.S. property (which triggers § 951(a)(1)(B)) and its subsequent dividend distributions are substantively unrelated transactions renders meritless SIHP's argument — raised for the first time on appeal — that the Commissioner's position in Notice 2004-70 somehow results in "timing-based anomalies" (Br.64-66).

"cannot now avoid [its] tax obligation simply because [it] regret[s] the specific decision [it] made." *Rodriguez*, 722 F.3d at 310.

CONCLUSION

The Tax Court's decision is correct and should be affirmed.

Respectfully submitted,

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NOVEMBER 2018

CERTIFICATE OF BAR MEMBERSHIP

Pursuant to Local Rule 28.3(d), it is hereby certified that, because the attorneys on this brief represent the Federal Government, the requirement that at least one attorney must be a member of the Bar of this Court is waived.

/s/ Judith A. Hagley
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(s) Judith A. Hagley

Attorney for the Appellee Commissioner

Dated: November 14, 2018

STATUTORY AND REGULATORY ADDENDUM

cuted, because item 956A "Earnings invested in excess passive assets" had been editorially supplied.

1986—Pub. L. 99–514, title XII, §1221(b)(3)(E), Oct. 22, 1986, 100 Stat. 2553, substituted "Insurance income" for "Income from insurance of United States risks" in item 953.

1975—Pub. L. 94–12, title VI, §602(a)(3)(A), (c)(7), (d)(3)(B), Mar. 29, 1975, 89 Stat. 58, 60, 64, struck out existing item 955 and replaced it with an identical item 955 and struck out item 963 "Receipt of minimum distributions by domestic corporations".

1962—Pub. L. 87–834, §12(a), Oct. 16, 1962, 76 Stat. 1006, added heading of subpart F, and items 951–964.

§ 951. Amounts included in gross income of United States shareholders

(a) Amounts included

(1) In general

If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year,

(ii) his pro rata share (determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year, and

(iii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from foreign base company shipping operations for such year; and

(B) the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

(2) Pro rata share of subpart F income

The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount—

(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

(B) the amount of distributions received by any other person during such year as a dividend with respect to such stock, but only to the extent of the dividend which would have been received if the distribution by the corporation had been the amount (i) which bears the same ratio to the subpart F income of such corporation for the taxable year, as (ii) the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire year.

For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved.

(3) Limitation on pro rata share of previously excluded subpart F income withdrawn from investment

For purposes of paragraph (1)(A)(iii), the pro rata share of any United States shareholder of the previously excluded subpart F income of a controlled foreign corporation withdrawn from investment in foreign base company shipping operations shall not exceed an amount—

(A) which bears the same ratio to his pro rata share of such income withdrawn (as determined under section 955(a)(3)) for the taxable year, as

(B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

(b) United States shareholder defined

For purposes of this subpart, the term "United States shareholder" means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

(c) Foreign trade income not taken into account

(1) In general

The foreign trade income of a FSC and any deductions which are apportioned or allocated to such income shall not be taken into account under this subpart.

(2) Foreign trade income

For purposes of this subsection, the term "foreign trade income" has the meaning given such term by section 923(b),[1] but does not include section 923(a)(2)[1] non-exempt income (within the meaning of section 927(d)(6)).[1]

(d) Coordination with passive foreign investment company provisions

If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 1293 (relating to current taxation of income from certain passive foreign investment companies), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A).

(Added Pub. L. 87–834, §12(a), Oct. 16, 1962, 76 Stat. 1006; amended Pub. L. 94–12, title VI, §602(a)(3)(B), (c)(3), (4), (d)(2), Mar. 29, 1975, 89

[1] See References in Text note below.

Stat. 58, 62; Pub. L. 94–455, title XIX, § 1901(a)(119), Oct. 4, 1976, 90 Stat. 1784; Pub. L. 98–369, div. A, title I, § 132(c)(1), title VIII, § 801(d)(4), July 18, 1984, 98 Stat. 666, 996; Pub. L. 99–514, title XII, § 1235(c), title XVIII, § 1876(c)(2), Oct. 22, 1986, 100 Stat. 2574, 2898; Pub. L. 100–647, title I, § 1012(i)(15), Nov. 10, 1988, 102 Stat. 3510; Pub. L. 103–66, title XIII, §§ 13231(a), 13232(c), Aug. 10, 1993, 107 Stat. 495, 502; Pub. L. 104–188, title I, § 1501(a)(1), Aug. 20, 1996, 110 Stat. 1825; Pub. L. 105–34, title XI, § 1112(a)(1), Aug. 5, 1997, 111 Stat. 969; Pub. L. 108–357, title IV, § 413(c)(16), Oct. 22, 2004, 118 Stat. 1508.)

REFERENCES IN TEXT

The Tax Reduction Act of 1975, referred to in subsec. (a)(1)(A)(ii), is Pub. L. 94–12, Mar. 29, 1975, 89 Stat. 26, as amended, which was enacted Mar. 29, 1975. For complete classification of this Act to the Code, see Short Title of 1975 Amendment note set out under section 1 of this title and Tables.

Sections 923 and 927, referred to in subsec. (c)(2), were repealed by Pub. L. 106–519, § 2, Nov. 15, 2000, 114 Stat. 2423.

AMENDMENTS

2004—Subsecs. (c) to (f). Pub. L. 108–357 redesignated subsecs. (e) and (f) as (c) and (d), respectively, and struck out former subsecs. (c) and (d), which related to coordination of provisions with election of a foreign investment company to distribute income and coordination with foreign personal holding company provisions, respectively.

1997—Subsec. (a)(2). Pub. L. 105–34 inserted concluding provisions "For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved."

1996—Subsec. (a)(1)(A) to (C). Pub. L. 104–188 inserted "and" at end of subpar. (A), substituted period for "; and" at end of subpar. (B), and struck out subpar. (C) which read as follows: "the amount determined under section 956A with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(3))."

1993—Subsec. (a)(1)(B). Pub. L. 103–66, § 13232(c)(1), substituted "the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)); and" for "his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)); and".

Subsec. (a)(1)(C). Pub. L. 103–66, § 13231(a), added subpar. (C).

Subsec. (a)(4). Pub. L. 103–66, § 13232(c)(2), struck out heading and text of par. (4). Text read as follows: "For purposes of paragraph (1)(B), the pro rata share of any United States shareholder in the increase of the earnings of a controlled foreign corporation invested in United States property shall not exceed an amount (A) which bears the same ratio to his pro rata share of such increase (as determined under section 956(a)(2)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year."

1988—Subsec. (b). Pub. L. 100–647 substituted "section 957(c)" for "section 957(d)".

1986—Subsec. (e)(1). Pub. L. 99–514, § 1876(c)(2), struck out last sentence which read as follows: "For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d) shall be treated as derived from sources within the United States."

Subsec. (f). Pub. L. 99–514, § 1235(c), added subsec. (f).

1984—Subsec. (d). Pub. L. 98–369, § 132(c)(1), amended subsec. (d) generally, substituting provision that, if a United States shareholder is required to include in gross income an amount under both subsec. (a)(1)(A)(ii) of this section and section 551(b) of this title, such amount be included only under subsec. (a)(1)(A)(ii) of this section for provision that, if a United States shareholder is subject to tax under section 551(b) of this title, such shareholder not be required to include as gross income any amount under subsec. (a) of this section.

Subsec. (e). Pub. L. 98–369, § 801(d)(4), added subsec. (e).

1976—Subsec. (a)(1). Pub. L. 94–455 struck out "beginning after December 31, 1962" after "during any taxable year".

1975—Subsec. (a)(1)(A)(i). Pub. L. 94–12, § 602(a)(3)(B), struck out "except as provided in section 963," before "his pro rata share".

Subsec. (a)(1)(A)(ii). Pub. L. 94–12, § 602(c)(3), substituted "(determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975)" for "(determined under section 955(a)(3))".

Subsec. (a)(1)(A)(iii). Pub. L. 94–12, § 602(d)(2)(A), added cl. (iii).

Subsec. (a)(3). Pub. L. 94–12, § 602(c)(4), (d)(2)(B), substituted "paragraph (i)(A)(iii)" for "paragraph (1)(A)(ii)" and "foreign base company shipping operations" for "less developed countries".

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108–357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108–357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1112(a)(2) of Pub. L. 105–34 provided that: "The amendment made by paragraph (1) [amending this section] shall apply to dispositions after the date of the enactment of this Act [Aug. 5, 1997]."

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as a note under section 904 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Section 13231(e) of Pub. L. 103–66 provided that: "The amendments made by this section [enacting section 956A of this title and amending this section and sections 959, 989, 1293, 1296, and 1297 of this title] shall apply to taxable years of foreign corporations beginning after September 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end."

Section 13232(d) of Pub. L. 103–66 provided that: "The amendments made by this section [amending this section and section 956 of this title] shall apply to taxable years of controlled foreign corporations beginning after September 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of controlled foreign corporations end."

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1235(c) of Pub. L. 99–514 applicable to taxable years of foreign corporations begin-

ning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99–514, set out as an Effective Date note under section 1291 of this title.

Amendment by section 1876(c)(2) of Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 132(d)(2)(A) of Pub. L. 98–369 provided that: "The amendment made by paragraph (1) of subsection (c) [amending this section] shall apply to taxable years of United States shareholders beginning after the date of the enactment of this Act [July 18, 1984]."

Amendment by section 801(d)(4) of Pub. L. 98–369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98–369, as amended, set out as a note under section 245 of this title.

EFFECTIVE DATE OF 1975 AMENDMENT

Amendment by Pub. L. 94–12 applicable to taxable years of foreign corporations beginning after Dec. 31, 1975, and to taxable years of United States shareholders (within the meaning of 951(b) of this title) within which or with which such taxable years of such foreign corporations end, see section 602(f) of Pub. L. 94–12, set out as an Effective Date note under section 955 of this title.

EFFECTIVE DATE

Section 12(c) of Pub. L. 87–834 provided that: "The amendments made by this section [enacting this section and sections 952 to 964 and 970 to 972 of this title and amending sections 901, 904, and 1016 of this title] shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable year of United States shareholders within which or with which such taxable years of such foreign corporations end."

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101–1147 and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

§ 952. Subpart F income defined

(a) In general

For purposes of this subpart, the term "subpart F income" means, in the case of any controlled foreign corporation, the sum of—

(1) insurance income (as defined under section 953),

(2) the foreign base company income (as determined under section 954),

(3) an amount equal to the product of—

(A) the income of such corporation other than income which—

(i) is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person under section 951 (other than by reason of this paragraph), or

(ii) is described in subsection (b),

multiplied by

(B) the international boycott factor (as determined under section 999),

(4) the sum of the amounts of any illegal bribes, kickbacks, or other payments (within the meaning of section 162(c)) paid by or on behalf of the corporation during the taxable year of the corporation directly or indirectly to an official, employee, or agent in fact of a government, and

(5) the income of such corporation derived from any foreign country during any period during which section 901(j) applies to such foreign country.

The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payor were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

(b) Exclusion of United States income

In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States. For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d)[1] shall be treated as derived from sources within the United States. For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account.

(c) Limitation

(1) In general

(A) Subpart F income limited to current earnings and profits

For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such taxable year.

(B) Certain prior year deficits may be taken into account

(i) In general

The amount included in the gross income of any United States shareholder under section 951(a)(1)(A)(i) for any taxable year and attributable to a qualified activity shall be reduced by the amount of such shareholder's pro rata share of any qualified deficit.

(ii) Qualified deficit

The term "qualified deficit" means any deficit in earnings and profits of the controlled foreign corporation for any prior taxable year which began after December 31, 1986, and for which the controlled foreign corporation was a controlled foreign corporation; but only to the extent such deficit—

(I) is attributable to the same qualified activity as the activity giving rise to the income being offset, and

[1] See References in Text note below.

"The amendments made by this section [enacting this section, amending sections 851, 902, 951, and 954 of this title, and repealing section 963 and former section 955 of this title] shall apply to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of United States shareholders (within the meaning of 951(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) within which or with which such taxable years of such foreign corporations end."

§ 956. Investment of earnings in United States property

(a) General rule

In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of—

(1) the excess (if any) of—

(A) such shareholder's pro rata share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close of each quarter of such taxable year, over

(B) the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder, or

(2) such shareholder's pro rata share of the applicable earnings of such controlled foreign corporation.

The amount taken into account under paragraph (1) with respect to any property shall be its adjusted basis as determined for purposes of computing earnings and profits, reduced by any liability to which the property is subject.

(b) Special rules

(1) Applicable earnings

For purposes of this section, the term "applicable earnings" means, with respect to any controlled foreign corporation, the sum of—

(A) the amount (not including a deficit) referred to in section 316(a)(1) to the extent such amount was accumulated in prior taxable years, and

(B) the amount referred to in section 316(a)(2),

but reduced by distributions made during the taxable year and by earnings and profits described in section 959(c)(1).

(2) Special rule for U.S. property acquired before corporation is a controlled foreign corporation

In applying subsection (a) to any taxable year, there shall be disregarded any item of United States property which was acquired by the controlled foreign corporation before the first day on which such corporation was treated as a controlled foreign corporation. The aggregate amount of property disregarded under the preceding sentence shall not exceed the portion of the applicable earnings of such controlled foreign corporation which were accumulated during periods before such first day.

(3) Special rule where corporation ceases to be controlled foreign corporation

If any foreign corporation ceases to be a controlled foreign corporation during any taxable year—

(A) the determination of any United States shareholder's pro rata share shall be made on the basis of stock owned (within the meaning of section 958(a)) by such shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation,

(B) the average referred to in subsection (a)(1)(A) for such taxable year shall be determined by only taking into account quarters ending on or before such last day, and

(C) in determining applicable earnings, the amount taken into account by reason of being described in paragraph (2) of section 316(a) shall be the portion of the amount so described which is allocable (on a pro rata basis) to the part of such year during which the corporation is a controlled foreign corporation.

(c) United States property defined

(1) In general

For purposes of subsection (a), the term "United States property" means any property acquired after December 31, 1962, which is—

(A) tangible property located in the United States;

(B) stock of a domestic corporation;

(C) an obligation of a United States person; or

(D) any right to the use in the United States of—

(i) a patent or copyright,

(ii) an invention, model, or design (whether or not patented),

(iii) a secret formula or process, or

(iv) any other similar right,

which is acquired or developed by the controlled foreign corporation for use in the United States.

(2) Exceptions

For purposes of subsection (a), the term "United States property" does not include—

(A) obligations of the United States, money, or deposits with—

(i) any bank (as defined by section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)), without regard to subparagraphs (C) and (G) of paragraph (2) of such section), or

(ii) any corporation not described in clause (i) with respect to which a bank holding company (as defined by section 2(a) of such Act) or financial holding company (as defined by section 2(p) of such Act) owns directly or indirectly more than 80 percent by vote or value of the stock of such corporation;

(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons;

(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;

(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business attributable to contracts which are not contracts described in section 953(a)(1);[1]

(F) the stock or obligations of a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, nor a domestic corporation, 25 percent or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the controlled foreign corporation, is owned, or is considered as being owned, by such United States shareholders in the aggregate;

(G) any movable property (other than a vessel or aircraft) which is used for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or under such waters when used on the Continental Shelf of the United States;

(H) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b);

(I) to the extent provided in regulations prescribed by the Secretary, property which is otherwise United States property which is held by a FSC and which is related to the export activities of such FSC;

(J) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person's business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin;

(K) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities;

(L) securities acquired and held by a controlled foreign corporation in the ordinary course of its business as a dealer in securities if—

(i) the dealer accounts for the securities as securities held primarily for sale to customers in the ordinary course of business, and

(ii) the dealer disposes of the securities (or such securities mature while held by the dealer) within a period consistent with the holding of securities for sale to customers in the ordinary course of business; and

(M) an obligation of a United States person which—

(i) is not a domestic corporation, and

(ii) is not—

(I) a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, or

(II) a partnership, estate, or trust in which the controlled foreign corporation, or any related person (as defined in section 954(d)(3)), is a partner, beneficiary, or trustee immediately after the acquisition of any obligation of such partnership, estate, or trust by the controlled foreign corporation.

For purposes of subparagraphs (J), (K), and (L), the term "dealer in securities" has the meaning given such term by section 475(c)(1), and the term "dealer in commodities" has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.

(3) Certain trade or service receivables acquired from related United States persons

(A) In general

Notwithstanding paragraph (2) (other than subparagraph (H) thereof), the term "United States property" includes any trade or service receivable if—

(i) such trade or service receivable is acquired (directly or indirectly) from a related person who is a United States person, and

(ii) the obligor under such receivable is a United States person.

(B) Definitions

For purposes of this paragraph, the term "trade or service receivable" and "related person" have the respective meanings given to such terms by section 864(d).

(d) Pledges and guarantees

For purposes of subsection (a), a controlled foreign corporation shall, under regulations prescribed by the Secretary, be considered as holding an obligation of a United States person if such controlled foreign corporation is a pledgor or guarantor of such obligations.

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to prevent the avoidance of the provisons[2] of this section through reorganizations or otherwise.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1015; amended Pub. L. 94–455, title X, § 1021(a), title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1618, 1834; Pub. L. 98–369, div. A, title I, § 123(b), title VIII, § 801(d)(8), July 18, 1984, 98 Stat. 646, 996; Pub. L. 99–514, title XVIII, § 1810(c)(1), Oct. 22, 1986, 100 Stat. 2824; Pub. L. 103–66, title XIII, § 13232(a), (b), Aug. 10, 1993, 107

[1] See References in Text note below.

[2] So in original. Probably should be "provisions".

Stat. 501; Pub. L. 104–188, title I, §1501(b)(2), (3), Aug. 20, 1996, 110 Stat. 1825; Pub. L. 105–34, title XI, §1173(a), title XVI, §1601(e), Aug. 5, 1997, 111 Stat. 988, 1090; Pub. L. 108–357, title IV, §407(a), (b), title VIII, §837(a), Oct. 22, 2004, 118 Stat. 1498, 1499, 1596.)

REFERENCES IN TEXT

Section 953(a)(1), referred to in subsec. (c)(2)(E), was subsequently amended, and section 953(a)(1) no longer describes contracts. However, contracts are described elsewhere in that section.

AMENDMENTS

2004—Subsec. (c)(2). Pub. L. 108–357, §407(b), substituted ", (K), and (L)" for "and (K)" in concluding provisions.

Subsec. (c)(2)(A). Pub. L. 108–357, §837(a), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: "obligations of the United States, money, or deposits with persons carrying on the banking business;".

Subsec. (c)(2)(L), (M). Pub. L. 108–357, §407(a), added subpars. (L) and (M).

1997—Subsec. (b)(1)(A). Pub. L. 105–34, §1601(e), inserted "to the extent such amount was accumulated in prior taxable years" after "section 316(a)(1)".

Subsec. (c)(2). Pub. L. 105–34, §1173(a), added subpars. (J) and (K) and concluding provisions.

1996—Subsec. (b)(1). Pub. L. 104–188, §1501(b)(2), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: "For purposes of this section, the term 'applicable earnings' has the meaning given to such term by section 956A(b), except that the provisions of such section excluding earnings and profits accumulated in taxable years beginning before October 1, 1993, shall be disregarded."

Subsec. (b)(3). Pub. L. 104–188, §1501(b)(3), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: "Rules similar to the rules of section 956A(e) shall apply for purposes of this section."

1993—Subsec. (a). Pub. L. 103–66, §13232(a)(2), added subsec. (a) and struck out former subsec. (a) which consisted of introductory provisions and pars. (1) to (3) setting out general rules for calculating amount of earnings of a controlled foreign corporation invested in United States and pro rata share of the increase for any taxable year in earnings of such a corporation invested in United States property.

Subsecs. (b) to (d). Pub. L. 103–66, §13232(a), added subsec. (b) and redesignated former subsecs. (b) and (c) as (c) and (d), respectively.

Subsec. (e). Pub. L. 103–66, §13232(b), added subsec. (e).

1986—Subsec. (b)(3)(A). Pub. L. 99–514 inserted "(other than subparagraph (H) thereof)".

1984—Subsec. (b)(2)(I). Pub. L. 98–369, §801(d)(8), added subpar. (I).

Subsec. (b)(3). Pub. L. 98–369, §123(b), added par. (3).

1976—Subsec. (b)(2)(F) to (H). Pub. L. 94–455, §1021(a), added subpars. (F) and (G) and redesignated former subpar. (F) as (H).

Subsec. (c). Pub. L. 94–455, §1906(b)(13)(A), struck out "or his delegate" after "Secretary".

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108–357, title IV, §407(c), Oct. 22, 2004, 118 Stat. 1499, provided that: "The amendments made by this section [amending this section] shall apply to taxable years of foreign corporations beginning after December 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end."

Pub. L. 108–357, title VIII, §837(b), Oct. 22, 2004, 118 Stat. 1596, provided that: "The amendment made by this section [amending this section] shall take effect on the date of the enactment of this Act [Oct. 22, 2004]."

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1173(b) of Pub. L. 105–34 provided that: "The amendments made by this section [amending this section] shall apply to taxable years of foreign corporations beginning after December 31, 1997, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end."

Amendment by section 1601(e) of Pub. L. 105–34 effective as if included in the provisions of the Small Business Job Protection Act of 1996, Pub. L. 104–188, to which it relates, see section 1601(j) of Pub. L. 105–34, set out as a note under section 23 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as a note under section 904 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103–66 applicable to taxable years of controlled foreign corporations beginning after Sept. 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of controlled foreign corporations end, see section 13232(d) of Pub. L. 103–66, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 123(b) of Pub. L. 98–369 applicable to accounts receivable and evidences of indebtedness transferred after Mar. 1, 1984, in taxable years ending after such date, with an exception, see section 123(c) of Pub. L. 98–369, set out as a note under section 864 of this title.

Amendment by section 801(d)(8) of Pub. L. 98–369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98–369, as amended, set out as a note under section 245 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1021(c) of Pub. L. 94–455, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: "The amendments made by this section [amending this section and section 958 of this title] shall apply to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of United States shareholders (within the meaning of section 951(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) within which or with which such taxable years of such foreign corporations end. In determining for purposes of any taxable year referred to in the preceding sentence the amount referred to in section 956(a)(2)(A) of the Internal Revenue Code of 1986 for the last taxable year of a corporation beginning before January 1, 1976, the amendments made by this section shall be deemed also to apply to such last taxable year."

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101–1147 and 1171–1177] or title XVIII [§§1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

[§ 956A. Repealed. Pub. L. 104–188, title I, § 1501(a)(2), Aug. 20, 1996, 110 Stat. 1825]

Section, added Pub. L. 103–66, title XIII, §13231(b), Aug. 10, 1993, 107 Stat. 496; amended Pub. L. 104–188,

title I, §1703(i)(2), (3), Aug. 20, 1996, 110 Stat. 1876, related to earnings invested in excess passive assets.

EFFECTIVE DATE OF REPEAL

Repeal by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as an Effective Date of 1996 Amendment note under section 904 of this title.

§ 957. Controlled foreign corporations; United States persons

(a) General rule

For purposes of this subpart, the term "controlled foreign corporation" means any foreign corporation if more than 50 percent of—

(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(2) the total value of the stock of such corporation,

is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

(b) Special rule for insurance

For purposes only of taking into account income described in section 953(a) (relating to insurance income), the term "controlled foreign corporation" includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock (or more than 25 percent of the total value of stock) is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of the reinsurance or the issuing of insurance or annuity contracts described in section 953(a)(1)[1] exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

(c) United States person

For purposes of this subpart, the term "United States person" has the meaning assigned to it by section 7701(a)(30) except that—

(1) with respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico, and

(2) with respect to a corporation organized under the laws of Guam, American Samoa, or the Northern Mariana Islands—

(A) 80 percent or more of the gross income of which for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within such a possession or was effectively connected with the conduct of a trade or business in such a possession, and

(B) 50 percent or more of the gross income of which for such period (or part) was derived from the active conduct of a trade or business within such a possession,

such term does not include an individual who is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands.

For purposes of subparagraphs (A) and (B) of paragraph (2), the determination as to whether income was derived from the active conduct of a trade or business within a possession shall be made under regulations prescribed by the Secretary.

(Added Pub. L. 87–834, §12(a), Oct. 16, 1962, 76 Stat. 1017; amended Pub. L. 94–455, title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 99–514, title XII, §§1221(b)(3)(C), 1222(a), 1224(a), 1273(a), Oct. 22, 1986, 100 Stat. 2553, 2556, 2558, 2595; Pub. L. 108–357, title VIII, §908(c)(5), Oct. 22, 2004, 118 Stat. 1656.)

REFERENCES IN TEXT

Section 953(a)(1), referred to in subsec. (b), was subsequently amended, and section 953(a)(1) no longer describes insurance or annuity contracts. However, insurance or annuity contracts are described elsewhere in that section.

AMENDMENTS

2004—Subsec. (c). Pub. L. 108–357, §908(c)(5)(B), struck out "derived from sources within a possession, was effectively connected with the conduct of a trade or business within a possession, or" after "whether income was" in concluding provisions.

Subsec. (c)(2)(B). Pub. L. 108–357, §908(c)(5)(A), substituted "active conduct of a" for "conduct of an active".

1986—Subsec. (a). Pub. L. 99–514, §1222(a)(1), amended subsec. (a) generally. Prior to amendment, subsec. (a) read as follows: "For purposes of this subpart, the term 'controlled foreign corporation' means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation."

Subsec. (b). Pub. L. 99–514, §1222(a)(2), inserted "(or more than 25 percent of the total value of stock)".

Pub. L. 99–514, §1221(b)(3)(C), substituted "insurance income" for "income derived from insurance of United States risks".

Subsec. (c). Pub. L. 99–514, §1273(a), added par. (2) and concluding provisions and struck out former pars. (2) and (3) which read as follows:

"(2) with respect to a corporation organized under the laws of the Virgin Islands, such term does not include an individual who is a bona fide resident of the Virgin Islands and whose income tax obligation under this subtitle for the taxable year is satisfied pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), by paying tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands, and

"(3) with respect to a corporation organized under the laws of any other possession of the United States, such term does not include an individual who is a bona fide resident of any such other possession and whose income

[1] See References in Text note below.

SUBPART F—CONTROLLED FOREIGN CORPORATIONS

AMENDMENTS

2004—Pub. L. 108–357, title IV, § 422(c), Oct. 22, 2004, 118 Stat. 1519, added item 965.

1996—Pub. L. 104–188, title I, § 1501(c), Aug. 20, 1996, 110 Stat. 1826, which directed that the analysis for subpart F be amended by striking item 956A, could not be executed, because item 956A "Earnings invested in excess passive assets" had been editorially supplied.

1986—Pub. L. 99–514, title XII, § 1221(b)(3)(E), Oct. 22, 1986, 100 Stat. 2553, substituted "Insurance income" for "Income from insurance of United States risks" in item 953.

1975—Pub. L. 94–12, title VI, § 602(a)(3)(A), (c)(7), (d)(3)(B), Mar. 29, 1975, 89 Stat. 58, 60, 64, struck out existing item 955 and replaced it with an identical item 955 and struck out item 963 "Receipt of minimum distributions by domestic corporations".

1962—Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1006, added heading of subpart F, and items 951–964.

§ 951. Amounts included in gross income of United States shareholders

(a) Amounts included

(1) In general

If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year,

(ii) his pro rata share (determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year, and

(iii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from foreign base company shipping operations for such year; and

(B) the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

(2) Pro rata share of subpart F income

The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount—

(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

(B) the amount of distributions received by any other person during such year as a dividend with respect to such stock, but only to the extent of the dividend which would have been received if the distribution by the corporation had been the amount (i) which bears the same ratio to the subpart F income of such corporation for the taxable year, as (ii) the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire year.

For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved.

(3) Limitation on pro rata share of previously excluded subpart F income withdrawn from investment

For purposes of paragraph (1)(A)(iii), the pro rata share of any United States shareholder of the previously excluded subpart F income of a controlled foreign corporation withdrawn from investment in foreign base company shipping operations shall not exceed an amount—

(A) which bears the same ratio to his pro rata share of such income withdrawn (as determined under section 955(a)(3)) for the taxable year, as

(B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

(b) United States shareholder defined

For purposes of this subpart, the term "United States shareholder" means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

(c) Coordination with passive foreign investment company provisions

If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 1293 (relating to current taxation of income from certain passive foreign investment companies), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A).

(Added Pub. L. 87–834, §12(a), Oct. 16, 1962, 76 Stat. 1006; amended Pub. L. 94–12, title VI, §602(a)(3)(B), (c)(3), (4), (d)(2), Mar. 29, 1975, 89 Stat. 58, 62; Pub. L. 94–455, title XIX, §1901(a)(119), Oct. 4, 1976, 90 Stat. 1784; Pub. L. 98–369, div. A, title I, §132(c)(1), title VIII, §801(d)(4), July 18, 1984, 98 Stat. 666, 996; Pub. L. 99–514, title XII, §1235(c), title XVIII, §1876(c)(2), Oct. 22, 1986, 100 Stat. 2574, 2898; Pub. L. 100–647, title I, §1012(i)(15), Nov. 10, 1988, 102 Stat. 3510; Pub. L. 103–66, title XIII, §§13231(a), 13232(c), Aug. 10, 1993, 107 Stat. 495, 502; Pub. L. 104–188, title I, §1501(a)(1), Aug. 20, 1996, 110 Stat. 1825; Pub. L. 105–34, title XI, §1112(a)(1), Aug. 5, 1997, 111 Stat. 969; Pub. L. 108–357, title IV, §413(c)(16), Oct. 22, 2004, 118 Stat. 1508; Pub. L. 110–172, §11(g)(13), Dec. 29, 2007, 121 Stat. 2490.)

REFERENCES IN TEXT

The Tax Reduction Act of 1975, referred to in subsec. (a)(1)(A)(ii), is Pub. L. 94–12, Mar. 29, 1975, 89 Stat. 26, as amended, which was enacted Mar. 29, 1975. For complete classification of this Act to the Code, see Short Title of 1975 Amendment note set out under section 1 of this title and Tables.

AMENDMENTS

2007—Subsecs. (c), (d). Pub. L. 110–172 redesignated subsec. (d) as (c) and struck out heading and text of former subsec. (c). Text read as follows:

"(1) IN GENERAL.—The foreign trade income of a FSC and any deductions which are apportioned or allocated to such income shall not be taken into account under this subpart.

"(2) FOREIGN TRADE INCOME.—For purposes of this subsection, the term 'foreign trade income' has the meaning given such term by section 923(b), but does not include section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6))."

2004—Subsecs. (c) to (f). Pub. L. 108–357 redesignated subsecs. (e) and (f) as (c) and (d), respectively, and struck out former subsecs. (c) and (d), which related to coordination of provisions with election of a foreign investment company to distribute income and coordination with foreign personal holding company provisions, respectively.

1997—Subsec. (a)(2). Pub. L. 105–34 inserted concluding provisions "For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved."

1996—Subsec. (a)(1)(A) to (C). Pub. L. 104–188 inserted "and" at end of subpar. (A), substituted period for "; and" at end of subpar. (B), and struck out subpar. (C) which read as follows: "the amount determined under section 956A with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(3))."

1993—Subsec. (a)(1)(B). Pub. L. 103–66, §13232(c)(1), substituted "the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)); and" for "his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)); and".

Subsec. (a)(1)(C). Pub. L. 103–66, §13231(a), added subpar. (C).

Subsec. (a)(4). Pub. L. 103–66, §13232(c)(2), struck out heading and text of par. (4). Text read as follows: "For purposes of paragraph (1)(B), the pro rata share of any United States shareholder in the increase of the earnings of a controlled foreign corporation invested in United States property shall not exceed an amount (A) which bears the same ratio to his pro rata share of such increase (as determined under section 956(a)(2)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year."

1988—Subsec. (b). Pub. L. 100–647 substituted "section 957(c)" for "section 957(d)".

1986—Subsec. (e)(1). Pub. L. 99–514, §1876(c)(2), struck out last sentence which read as follows: "For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d) shall be treated as derived from sources within the United States."

Subsec. (f). Pub. L. 99–514, §1235(c), added subsec. (f).

1984—Subsec. (d). Pub. L. 98–369, §132(c)(1), amended subsec. (d) generally, substituting provision that, if a United States shareholder is required to include in gross income an amount under both subsec. (a)(1)(A)(ii) of this section and section 551(b) of this title, such amount be included only under subsec. (a)(1)(A)(ii) of this section for provision that, if a United States shareholder is subject to tax under section 551(b) of this title, such shareholder not be required to include as gross income any amount under subsec. (a) of this section.

Subsec. (e). Pub. L. 98–369, §801(d)(4), added subsec. (e).

1976—Subsec. (a)(1). Pub. L. 94–455 struck out "beginning after December 31, 1962" after "during any taxable year".

1975—Subsec. (a)(1)(A)(i). Pub. L. 94–12, §602(a)(3)(B), struck out "except as provided in section 963," before "his pro rata share".

Subsec. (a)(1)(A)(ii). Pub. L. 94–12, §602(c)(3), substituted "(determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975)" for "(determined under section 955(a)(3))".

Subsec. (a)(1)(A)(iii). Pub. L. 94–12, §602(d)(2)(A), added cl. (iii).

Subsec. (a)(3). Pub. L. 94–12, §602(c)(4), (d)(2)(B), substituted "paragraph (i)(A)(iii)" for "paragraph (1)(A)(ii)" and "foreign base company shipping operations" for "less developed countries".

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108–357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108–357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105–34, title XI, §1112(a)(2), Aug. 5, 1997, 111 Stat. 969, provided that: "The amendment made by paragraph (1) [amending this section] shall apply to dispositions after the date of the enactment of this Act [Aug. 5, 1997]."

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as a note under section 904 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Pub. L. 103–66, title XIII, §13231(e), Aug. 10, 1993, 107 Stat. 501, provided that: "The amendments made by

this section [enacting section 956A of this title and amending this section and sections 959, 989, 1293, 1296, and 1297 of this title] shall apply to taxable years of foreign corporations beginning after September 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end."

Pub. L. 103–66, title XIII, §13232(d), Aug. 10, 1993, 107 Stat. 502, provided that: "The amendments made by this section [amending this section and section 956 of this title] shall apply to taxable years of controlled foreign corporations beginning after September 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of controlled foreign corporations end."

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1235(c) of Pub. L. 99–514 applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99–514, set out as an Effective Date note under section 1291 of this title.

Amendment by section 1876(c)(2) of Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Pub. L. 98–369, div. A, title I, §132(d)(2)(A), July 18, 1984, 98 Stat. 667, provided that: "The amendment made by paragraph (1) of subsection (c) [amending this section] shall apply to taxable years of United States shareholders beginning after the date of the enactment of this Act [July 18, 1984]."

Amendment by section 801(d)(4) of Pub. L. 98–369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98–369, as amended, set out as a note under section 245 of this title.

EFFECTIVE DATE OF 1975 AMENDMENT

Amendment by Pub. L. 94–12 applicable to taxable years of foreign corporations beginning after Dec. 31, 1975, and to taxable years of United States shareholders (within the meaning of 951(b) of this title) within which or with which such taxable years of such foreign corporations end, see section 602(f) of Pub. L. 94–12, set out as an Effective Date note under section 955 of this title.

EFFECTIVE DATE

Pub. L. 87–834, §12(c), Oct. 16, 1962, 76 Stat. 1031, provided that: "The amendments made by this section [enacting this section and sections 952 to 964 and 970 to 972 of this title and amending sections 901, 904, and 1016 of this title] shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable year of United States shareholders within which or with which such taxable years of such foreign corporations end."

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101–1147 and 1171–1177] or title XVIII [§§1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

§952. Subpart F income defined

(a) In general

For purposes of this subpart, the term "subpart F income" means, in the case of any controlled foreign corporation, the sum of—

(1) insurance income (as defined under section 953),

(2) the foreign base company income (as determined under section 954),

(3) an amount equal to the product of—

(A) the income of such corporation other than income which—

(i) is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person under section 951 (other than by reason of this paragraph), or

(ii) is described in subsection (b),

multiplied by

(B) the international boycott factor (as determined under section 999),

(4) the sum of the amounts of any illegal bribes, kickbacks, or other payments (within the meaning of section 162(c)) paid by or on behalf of the corporation during the taxable year of the corporation directly or indirectly to an official, employee, or agent in fact of a government, and

(5) the income of such corporation derived from any foreign country during any period during which section 901(j) applies to such foreign country.

The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payor were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

(b) Exclusion of United States income

In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States. For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account.

(c) Limitation

(1) In general

(A) Subpart F income limited to current earnings and profits

For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such taxable year.

(B) Certain prior year deficits may be taken into account

(i) In general

The amount included in the gross income of any United States shareholder

Stat. 2095, provided that: "The amendments made by this section [enacting this section, amending sections 851, 902, 951, and 954 of this title, and repealing section 963 and former section 955 of this title] shall apply to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of United States shareholders (within the meaning of 951(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) within which or with which such taxable years of such foreign corporations end."

§ 956. Investment of earnings in United States property

(a) General rule

In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of—

(1) the excess (if any) of—

(A) such shareholder's pro rata share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close of each quarter of such taxable year, over

(B) the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder, or

(2) such shareholder's pro rata share of the applicable earnings of such controlled foreign corporation.

The amount taken into account under paragraph (1) with respect to any property shall be its adjusted basis as determined for purposes of computing earnings and profits, reduced by any liability to which the property is subject.

(b) Special rules

(1) Applicable earnings

For purposes of this section, the term "applicable earnings" means, with respect to any controlled foreign corporation, the sum of—

(A) the amount (not including a deficit) referred to in section 316(a)(1) to the extent such amount was accumulated in prior taxable years, and

(B) the amount referred to in section 316(a)(2),

but reduced by distributions made during the taxable year and by earnings and profits described in section 959(c)(1).

(2) Special rule for U.S. property acquired before corporation is a controlled foreign corporation

In applying subsection (a) to any taxable year, there shall be disregarded any item of United States property which was acquired by the controlled foreign corporation before the first day on which such corporation was treated as a controlled foreign corporation. The aggregate amount of property disregarded under the preceding sentence shall not exceed the portion of the applicable earnings of such controlled foreign corporation which were accumulated during periods before such first day.

(3) Special rule where corporation ceases to be controlled foreign corporation

If any foreign corporation ceases to be a controlled foreign corporation during any taxable year—

(A) the determination of any United States shareholder's pro rata share shall be made on the basis of stock owned (within the meaning of section 958(a)) by such shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation,

(B) the average referred to in subsection (a)(1)(A) for such taxable year shall be determined by only taking into account quarters ending on or before such last day, and

(C) in determining applicable earnings, the amount taken into account by reason of being described in paragraph (2) of section 316(a) shall be the portion of the amount so described which is allocable (on a pro rata basis) to the part of such year during which the corporation is a controlled foreign corporation.

(c) United States property defined

(1) In general

For purposes of subsection (a), the term "United States property" means any property acquired after December 31, 1962, which is—

(A) tangible property located in the United States;

(B) stock of a domestic corporation;

(C) an obligation of a United States person; or

(D) any right to the use in the United States of—

(i) a patent or copyright,

(ii) an invention, model, or design (whether or not patented),

(iii) a secret formula or process, or

(iv) any other similar right,

which is acquired or developed by the controlled foreign corporation for use in the United States.

(2) Exceptions

For purposes of subsection (a), the term "United States property" does not include—

(A) obligations of the United States, money, or deposits with—

(i) any bank (as defined by section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)), without regard to subparagraphs (C) and (G) of paragraph (2) of such section), or

(ii) any corporation not described in clause (i) with respect to which a bank holding company (as defined by section 2(a) of such Act) or financial holding company (as defined by section 2(p) of such Act) owns directly or indirectly more than 80 percent by vote or value of the stock of such corporation;

(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the

United States person had the sale or processing transaction been made between unrelated persons;

(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;

(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business attributable to contracts which are not contracts described in section 953(a)(1);[1]

(F) the stock or obligations of a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, nor a domestic corporation, 25 percent or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the controlled foreign corporation, is owned, or is considered as being owned, by such United States shareholders in the aggregate;

(G) any movable property (other than a vessel or aircraft) which is used for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or under such waters when used on the Continental Shelf of the United States;

(H) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b);

(I) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person's business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin;

(J) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities;

(K) securities acquired and held by a controlled foreign corporation in the ordinary course of its business as a dealer in securities if—

(i) the dealer accounts for the securities as securities held primarily for sale to customers in the ordinary course of business, and

(ii) the dealer disposes of the securities (or such securities mature while held by the dealer) within a period consistent with the holding of securities for sale to customers in the ordinary course of business; and

(L) an obligation of a United States person which—

(i) is not a domestic corporation, and

(ii) is not—

(I) a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, or

(II) a partnership, estate, or trust in which the controlled foreign corporation, or any related person (as defined in section 954(d)(3)), is a partner, beneficiary, or trustee immediately after the acquisition of any obligation of such partnership, estate, or trust by the controlled foreign corporation.

For purposes of subparagraphs (I), (J), and (K), the term "dealer in securities" has the meaning given such term by section 475(c)(1), and the term "dealer in commodities" has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.

(3) Certain trade or service receivables acquired from related United States persons

(A) In general

Notwithstanding paragraph (2) (other than subparagraph (H) thereof), the term "United States property" includes any trade or service receivable if—

(i) such trade or service receivable is acquired (directly or indirectly) from a related person who is a United States person, and

(ii) the obligor under such receivable is a United States person.

(B) Definitions

For purposes of this paragraph, the term "trade or service receivable" and "related person" have the respective meanings given to such terms by section 864(d).

(d) Pledges and guarantees

For purposes of subsection (a), a controlled foreign corporation shall, under regulations prescribed by the Secretary, be considered as holding an obligation of a United States person if such controlled foreign corporation is a pledgor or guarantor of such obligations.

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to prevent the avoidance of the provisons[2] of this section through reorganizations or otherwise.

(Added Pub. L. 87–834, §12(a), Oct. 16, 1962, 76 Stat. 1015; amended Pub. L. 94–455, title X, §1021(a), title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1618, 1834; Pub. L. 98–369, div. A, title I, §123(b), title VIII, §801(d)(8), July 18, 1984, 98 Stat. 646, 996; Pub. L. 99–514, title XVIII, §1810(c)(1), Oct. 22, 1986, 100 Stat. 2824; Pub. L. 103–66, title XIII, §13232(a), (b), Aug. 10, 1993, 107 Stat. 501; Pub. L. 104–188, title I, §1501(b)(2), (3),

[1] See References in Text note below.

[2] So in original. Probably should be "provisions".

Aug. 20, 1996, 110 Stat. 1825; Pub. L. 105–34, title XI, §1173(a), title XVI, §1601(e), Aug. 5, 1997, 111 Stat. 988, 1090; Pub. L. 108–357, title IV, §407(a), (b), title VIII, §837(a), Oct. 22, 2004, 118 Stat. 1498, 1499, 1596; Pub. L. 110–172, §11(g)(15)(A), Dec. 29, 2007, 121 Stat. 2490.)

REFERENCES IN TEXT

Section 953(a)(1), referred to in subsec. (c)(2)(E), was subsequently amended, and section 953(a)(1) no longer describes contracts. However, contracts are described elsewhere in that section.

AMENDMENTS

2007—Subsec. (c)(2). Pub. L. 110–172, §11(g)(15)(A)(ii), substituted "subparagraphs (I), (J), and (K)" for "subparagraphs (J), (K), and (L)" in concluding provisions.

Subsec. (c)(2)(I) to (M). Pub. L. 110–172, §11(g)(15)(A)(i), redesignated subpars. (J) to (M) as (I) to (L), respectively, and struck out former subpar. (I) which read as follows: "to the extent provided in regulations prescribed by the Secretary, property which is otherwise United States property which is held by a FSC and which is related to the export activities of such FSC;".

2004—Subsec. (c)(2). Pub. L. 108–357, §407(b), substituted ", (K), and (L)" for "and (K)" in concluding provisions.

Subsec. (c)(2)(A). Pub. L. 108–357, §837(a), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: "obligations of the United States, money, or deposits with persons carrying on the banking business;".

Subsec. (c)(2)(L), (M). Pub. L. 108–357, §407(a), added subpars. (L) and (M).

1997—Subsec. (b)(1)(A). Pub. L. 105–34, §1601(e), inserted "to the extent such amount was accumulated in prior taxable years" after "section 316(a)(1)".

Subsec. (c)(2). Pub. L. 105–34, §1173(a), added subpars. (J) and (K) and concluding provisions.

1996—Subsec. (b)(1). Pub. L. 104–188, §1501(b)(2), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: "For purposes of this section, the term 'applicable earnings' has the meaning given to such term by section 956A(b), except that the provisions of such section excluding earnings and profits accumulated in taxable years beginning before October 1, 1993, shall be disregarded."

Subsec. (b)(3). Pub. L. 104–188, §1501(b)(3), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: "Rules similar to the rules of section 956A(e) shall apply for purposes of this section."

1993—Subsec. (a). Pub. L. 103–66, §13232(a)(2), added subsec. (a) and struck out former subsec. (a) which consisted of introductory provisions and pars. (1) to (3) setting out general rules for calculating amount of earnings of a controlled foreign corporation invested in United States and pro rata share of the increase for any taxable year in earnings of such a corporation invested in United States property.

Subsecs. (b) to (d). Pub. L. 103–66, §13232(a), added subsec. (b) and redesignated former subsecs. (b) and (c) as (c) and (d), respectively.

Subsec. (e). Pub. L. 103–66, §13232(b), added subsec. (e).

1986—Subsec. (b)(3)(A). Pub. L. 99–514 inserted "(other than subparagraph (H) thereof)".

1984—Subsec. (b)(2)(I). Pub. L. 98–369, §801(d)(8), added subpar. (I).

Subsec. (b)(3). Pub. L. 98–369, §123(b), added par. (3).

1976—Subsec. (b)(2)(F) to (H). Pub. L. 94–455, §1021(a), added subpars. (F) and (G) and redesignated former subpar. (F) as (H).

Subsec. (c). Pub. L. 94–455, §1906(b)(13)(A), struck out "or his delegate" after "Secretary".

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108–357, title IV, §407(c), Oct. 22, 2004, 118 Stat. 1499, provided that: "The amendments made by this section [amending this section] shall apply to taxable years of foreign corporations beginning after December 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end."

Pub. L. 108–357, title VIII, §837(b), Oct. 22, 2004, 118 Stat. 1596, provided that: "The amendment made by this section [amending this section] shall take effect on the date of the enactment of this Act [Oct. 22, 2004]."

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105–34, title XI, §1173(b), Aug. 5, 1997, 111 Stat. 989, provided that: "The amendments made by this section [amending this section] shall apply to taxable years of foreign corporations beginning after December 31, 1997, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end."

Amendment by section 1601(e) of Pub. L. 105–34 effective as if included in the provisions of the Small Business Job Protection Act of 1996, Pub. L. 104–188, to which it relates, see section 1601(j) of Pub. L. 105–34, set out as a note under section 23 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as a note under section 904 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103–66 applicable to taxable years of controlled foreign corporations beginning after Sept. 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of controlled foreign corporations end, see section 13232(d) of Pub. L. 103–66, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 123(b) of Pub. L. 98–369 applicable to accounts receivable and evidences of indebtedness transferred after Mar. 1, 1984, in taxable years ending after such date, with an exception, see section 123(c) of Pub. L. 98–369, set out as a note under section 864 of this title.

Amendment by section 801(d)(8) of Pub. L. 98–369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98–369, as amended, set out as a note under section 245 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Pub. L. 94–455, title X, §1021(c), Oct. 4, 1976, 90 Stat. 1619, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: "The amendments made by this section [amending this section and section 958 of this title] shall apply to taxable years of foreign corporations beginning after December 31, 1975, and to taxable years of United States shareholders (within the meaning of section 951(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) within which or with which such taxable years of such foreign corporations end. In determining for purposes of any taxable year referred to in the preceding sentence the amount referred to in section 956(a)(2)(A) of the Internal Revenue Code of 1986 for the last taxable year of a corporation beginning before January 1, 1976, the amendments made by this section shall be deemed also to apply to such last taxable year."

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101–1147 and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

[§ 956A. Repealed. Pub. L. 104–188, title I, § 1501(a)(2), Aug. 20, 1996, 110 Stat. 1825]

Section, added Pub. L. 103–66, title XIII, § 13231(b), Aug. 10, 1993, 107 Stat. 496; amended Pub. L. 104–188, title I, § 1703(i)(2), (3), Aug. 20, 1996, 110 Stat. 1876, related to earnings invested in excess passive assets.

EFFECTIVE DATE OF REPEAL

Repeal by Pub. L. 104–188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104–188, set out as an Effective Date of 1996 Amendment note under section 904 of this title.

§ 957. Controlled foreign corporations; United States persons

(a) General rule

For purposes of this subpart, the term "controlled foreign corporation" means any foreign corporation if more than 50 percent of—

(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(2) the total value of the stock of such corporation,

is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

(b) Special rule for insurance

For purposes only of taking into account income described in section 953(a) (relating to insurance income), the term "controlled foreign corporation" includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock (or more than 25 percent of the total value of stock) is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of the reinsurance or the issuing of insurance or annuity contracts described in section 953(a)(1)[1] exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

(c) United States person

For purposes of this subpart, the term "United States person" has the meaning assigned to it by section 7701(a)(30) except that—

(1) with respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico, and

(2) with respect to a corporation organized under the laws of Guam, American Samoa, or the Northern Mariana Islands—

(A) 80 percent or more of the gross income of which for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within such a possession or was effectively connected with the conduct of a trade or business in such a possession, and

(B) 50 percent or more of the gross income of which for such period (or part) was derived from the active conduct of a trade or business within such a possession,

such term does not include an individual who is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands.

For purposes of subparagraphs (A) and (B) of paragraph (2), the determination as to whether income was derived from the active conduct of a trade or business within a possession shall be made under regulations prescribed by the Secretary.

(Added Pub. L. 87–834, § 12(a), Oct. 16, 1962, 76 Stat. 1017; amended Pub. L. 94–455, title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 99–514, title XII, §§ 1221(b)(3)(C), 1222(a), 1224(a), 1273(a), Oct. 22, 1986, 100 Stat. 2553, 2556, 2558, 2595; Pub. L. 108–357, title VIII, § 908(c)(5), Oct. 22, 2004, 118 Stat. 1656.)

REFERENCES IN TEXT

Section 953(a)(1), referred to in subsec. (b), was subsequently amended, and section 953(a)(1) no longer describes insurance or annuity contracts. However, insurance or annuity contracts are described elsewhere in that section.

AMENDMENTS

2004—Subsec. (c). Pub. L. 108–357, § 908(c)(5)(B), struck out "derived from sources within a possession, was effectively connected with the conduct of a trade or business within a possession, or" after "whether income was" in concluding provisions.

Subsec. (c)(2)(B). Pub. L. 108–357, § 908(c)(5)(A), substituted "active conduct of a" for "conduct of an active".

1986—Subsec. (a). Pub. L. 99–514, § 1222(a)(1), amended subsec. (a) generally. Prior to amendment, subsec. (a) read as follows: "For purposes of this subpart, the term 'controlled foreign corporation' means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation."

Subsec. (b). Pub. L. 99–514, § 1222(a)(2), inserted "(or more than 25 percent of the total value of stock)".

Pub. L. 99–514, § 1221(b)(3)(C), substituted "insurance income" for "income derived from insurance of United States risks".

Subsec. (c). Pub. L. 99–514, § 1273(a), added par. (2) and concluding provisions and struck out former pars. (2) and (3) which read as follows:

[1] See References in Text note below.

(d) *Illustrations.* The application of this section may be illustrated by the following examples:

Example 1. Foreign corporation A is a wholly owned subsidiary of domestic corporation M. Both corporations use the calendar year as a taxable year. In a statement filed with its return for 1977, M makes an election under section 955(b)(3) and the election remains in force for the taxable year 1978. At December 31, 1978, A's qualified investments in foreign base company shipping operations amount to $100,000; and, at December 31, 1979, to $80,000. For purposes of paragraph (a)(1) of this section, A Corporation's decrease in qualified investments in foreign base company shipping operations for the taxable year 1978 is $20,000 and is determined by ascertaining the amount by which A Corporation's qualified investments in foreign base company shipping operations at December 31, 1978 ($100,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1979 ($80,000).

Example 2. The facts are the same as in example 1 except that A experiences no changes in qualified investments in foreign base company shipping operations during its taxable years 1980 and 1981. If M's election were to remain in force, A's acquisitions and dispositions of qualified investments in foreign base company shipping operations during A's taxable year 1982 would be taken into account in determining whether A has experienced an increase or a decrease in qualified investments in foreign base company shipping operations for its taxable year 1981. However, M duly files before the close of A's taxable year 1981 as application for consent to revocation of M Corporation's election under section 955(b)(3), and, pursuant to an agreement between the Commissioner and M, consent is granted by the Commissioner. Assuming such agreement does not provide otherwise, A's change in qualifed investments in foreign base company shipping operations for its taxable year 1981 is zero because the effect of the revocation of the election is to treat acquisitions and dispositions of qualified investments in foreign base company shipping operations actually occurring in 1982 as having occurred in such year rather than in 1981.

Example 3. The facts are the same as in example 2 except that A's qualified investments in foreign base company shipping operations at December 31, 1982, amount to $70,000. For purposes of paragraph (b)(1)(i) of §1.955A–1, the decrease in A's qualified investments in foreign base company shipping operations for the taxable year 1982 is $10,000 and is determined by ascertaining the amount by which A's qualified investments in foreign base company shipping operations at December 31, 1981 ($80,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1982 ($70,000).

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

[T.D. 7894, 48 FR 22539, May 19, 1983]

§ 1.956–1 Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property.

(a) *In general.* Section 956(a)(1) and paragraph (b) of this section provide rules for determining the amount of a controlled foreign corporation's earnings invested in United States property at the close of any taxable year. Such amount is the aggregate amount invested in United States property to the extent such amount would have constituted a dividend if it had been distributed on such date. Subject to the provisions of section 951(a)(4) and the regulations thereunder, a United States shareholder of a controlled foreign corporation is required to include in his gross income his pro rata share,

as determined in accordance with paragraph (c) of this section, of the controlled foreign corporation's increase for any taxable year in earnings invested in United States property but only to the extent such share is not excludable from his gross income under the provisions of section 959(a)(2) and the regulations thereunder.

(b) *Amount of a controlled foreign corporation's investment of earnings in United States property*—(1) *Dividend limitation.* The amount of a controlled foreign corporation's earnings invested at the close of its taxable year in United States property is the aggregate amount of such property held, directly or indirectly, by such corporation at the close of its taxable year to the extent such amount would have constituted a dividend under section 316 and §§1.316–1 and 1.316–2 (determined after the application of section 955(a)) if it had been distributed on such closing day. For purposes of this subparagraph, the determination of whether an amount would have constituted a dividend if distributed shall be made without regard to the provisions of section 959(d) and the regulations thereunder.

(2) *Aggregate amount of United States property.* For purposes of determining an increase in earnings invested in United States property for any taxable year beginning after December 31, 1975, the aggregate amount of United States property held by a controlled foreign corporation at the close of—

(i) Any taxable year beginning after December 31, 1975, and

(ii) The last taxable year beginning before January 1, 1976 does not include stock or obligations of a domestic corporation described in section 956(b)(2)(F) or movable property described in section 956(b)(2)(G).

(3) *Treatment of earnings and profits.* For purposes of making the determination under subparagraph (1) of this paragraph as to whether an amount of investment would have constituted a dividend if distributed at the close of any taxable year of a controlled foreign corporation, earnings and profits of the controlled foreign corporation shall be considered not to include any amounts which are attributable to—

(i) Amounts which have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 951(a)(1)(B) (or which would have been so included but for section 959(a)(2)) and have not been distributed, or

(ii)(*a*) Amounts which are included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) or would be so included under such section but for the fact that such amounts were distributed to such shareholder during the taxable year, or

(*b*) Amounts which, for any prior taxable year, have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) and have not been distributed.

The rules of this subparagraph apply only in determining the limitation on a controlled foreign corporation's increase in earnings invested in United States property. See section 959 and the regulations thereunder for limitations on the exclusion from gross income of previously taxed earnings and profits.

(4) [Reserved]

(c) *Shareholder's pro rata share of increase*—(1) *General rule.* A United States shareholder's pro rata share of a controlled foreign corporation's increase for any taxable year in earnings invested in United States property is the amount determined by subtracting the shareholder's pro rata share of—

(i) The controlled foreign corporation's earnings invested in United States property at the close of its preceding taxable year, as determined under paragraph (b) of this section, reduced by amounts paid by such corporation during such preceding taxable year to which section 959(c)(1) and the regulations thereunder apply, from his pro rata share of

(ii) The controlled foreign corporation's earnings invested in United States property at the close of its current taxable year, as determined under paragraph (b) of this section.

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

Example 1. A is a United States shareholder and direct owner of 60 percent of the only class of stock of R Corporation, a controlled foreign corporation during the entire period

here involved. Both A and R Corporation use the calendar year as a taxable year. Corporation R's aggregate investment in United States property on December 31, 1964, which would constitute a dividend (as determined under paragraph (b) of this section) if distributed on such date is $150,000. During the taxable year 1964, R Corporation distributed $50,000 to which section 959(c)(1) applies. Corporation R's aggregate investment in United States property on December 31, 1965, is $250,000; and R Corporation's current and accumulated earnings and profits on such date (determined as provided in paragraph (b) of this section) are $225,000. A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property is $75,000, determined as follows:

(i) Aggregate investment in United States property on December 31, 1965		$250,000
(ii) Current and accumulated earnings and profits on December 31, 1965		225,000
(iii) Amount of earnings invested in United States property on December 31, 1965, which would constitute a dividend if distributed on such date (lesser of item (i) or item (ii))		225,000
(iv) Aggregate investment in United States property on December 31, 1964, which would constitute a dividend if distributed on such date	$150,000	
Less: Amounts distributed during 1964 to which section 959(c)(1) applies	50,000	100,000
(v) R Corporation's increase for 1965 in earnings invested in United States property (item (iii) minus item (iv))		125,000
(vi) A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property (item (v) times 60 percent)		75,000

Example 2. The facts are the same as in example 1, except that R Corporation's current and accumulated earnings and profits on December 31, 1965, are $100,000 instead of $225,000. Accordingly, even through R Corporation's aggregate investment in United States property on December 31, 1965, of $250,000 exceeds the net amount ($100,000) taken into account under subparagraph (1)(i) of this paragraph as of December 31, 1964, by $150,000, there is no increase for taxable year 1965 in earnings invested in United States property because of the dividend limitation of paragraph (b)(1) of this section. Corporation R's aggregate investment in United States property on December 31, 1966, is unchanged ($250,000) Corporation R's current and accumulated earnings and profits on December 31, 1966, are $175,000, and, as a consequence, its aggregate investment in United States property which would constitute a dividend if distributed on that date is $175,000. Corporation R pays no amount during 1965 to which section 959(c)(1) applies. Corporation R's increase for the taxable year 1966 in earnings invested in United States property is $75,000, and A's pro rata share of that amount is $45,000 ($75,000 times 60 percent).

(d) *Date and basis of determinations.* The determinations made under paragraph (c)(1)(i) of this section with respect to the close of the preceding taxable year of a controlled foreign corporation and under paragraph (c)(1)(ii) with respect to the close of the current taxable year of such controlled foreign corporation, for purposes of determining the United States shareholder's pro rata share of such corporation's increased investment of earnings in United States property for the current taxable year, shall be made as of the last day of the current taxable year of such corporation but on the basis of stock owned, within the meaning of section 958(a) and the regulations thereunder, by such United States shareholder on the last day of the current taxable year of the foreign corporation on which such corporation is a controlled foreign corporation. See the last sentence of section 956(a)(2). The application of this paragraph may be illustrated from the following example:

Example. Domestic corporation M owns 60 percent of the only class of stock of A Corporation, a controlled foreign corporation during the entire period here involved. Both M Corporation and A Corporation use the calendar year as a taxable year. Corporation A's investment of earnings in United States property at the close of the taxable year 1963 is $100,000, as determined under paragraph (b) of this section, and M Corporation includes its pro rata share of such amount ($60,000) in gross income for its taxable year 1963. On June 1, 1964, M Corporation acquires an additional 25 percent of A Corporation's outstanding stock from a person who is not a United States person as defined in section 957(d). Corporation A's investment of earnings in United States property at the close of the taxable year 1964, as determined under paragraph (b) of this section, is unchanged ($100,000). Corporation A pays no amount during 1963 to which section 959(c)(1) applies. Corporation M is not required, by reason of the acquisition in 1964 of A Corporation's stock, to include an additional amount in its gross income with respect to A Corporation's investment of earnings in United States property even though the earnings invested in United States property by A Corporation attributable to the stock acquired by M Corporation were not previously taxed. The determination made under paragraph (c)(1)(i)

of this section as well as the determination made under paragraph (c)(1)(ii) of this section with respect to A Corporation's investment for 1964 of earnings in United States property are made on the basis of stock owned by M Corporation (85 percent) at the close of 1964.

(e) *Amount attributable to property*—(1) *General rule.* Except as provided in subparagraph (2) of this paragraph, for purposes of paragraph (b)(1) of this section the amount taken into account with respect to any United States property shall be its adjusted basis, as of the applicable determination date, reduced by any liability (other than a liability described in subparagraph (3) of this paragraph) to which such property is subject on such date. To be taken into account under this subparagraph, a liability must constitute a specific charge against the property involved. Thus, a liability evidenced by an open account or a liability secured only by the general credit of the controlled foreign corporation will not be taken into account. On the other hand, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item on the applicable determination date bears to the adjusted basis of all such items at such time. A liability in excess of the adjusted basis of the property which is subject to such liability shall not be taken into account for the purpose of reducing the adjusted basis of other property which is not subject to such liability.

(2) *Rule for pledges and guarantees.* For purposes of this section the amount taken into account with respect to any pledge or guarantee described in paragraph (c)(1) of §1.956–2 shall be the unpaid principal amount on the applicable determination date of the obligation with respect to which the controlled foreign corporation is a pledgor or guarantor.

(3) *Excluded charges.* For purposes of subparagraph (1) of this paragraph, a specific charge created with respect to any item of property principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation's investment of earnings in United States property will not be recognized; whether a specific charge is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to a loan is whether the loan is from a related person, as defined in section 954 (d)(3) and paragraph (e) of §1.954–1.

(4) *Statement required.* If for purposes of this section a United States shareholder of a controlled foreign corporation reduces the adjusted basis of property which constitutes United States property on the ground that such property is subject to a liability, he shall attach to his return a statement setting forth the adjusted basis of the property before the reduction and the amount and nature of the reduction.

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

[T.D. 6704, 29 FR 2600, Feb. 20, 1964, as amended by T.D. 6795, 30 FR 942, Jan. 29, 1965; T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 8209, 53 FR 22171, June 14, 1988]

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

(a) [Reserved]

(b)(1)–(3) [Reserved]

(4) *Treatment of certain investments of earnings in United States Property*—(i) *Special rule.* For purposes of §1.956–1(b)(1) of the regulations, a controlled foreign corporation will be considered to hold indirectly (A) the investments in United States property held on its behalf by a trustee or a nominee or (B) at the discretion of the District Director, investments in U.S. property acquired by any other foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application of section 956 with respect to the controlled foreign corporation. For purposes of this paragraph (b), a foreign corporation will be controlled by the controlled foreign corporation if

the foreign corporation and the controlled foreign corporation are related parties under section 267(b). In determining for purposes of this paragraph (b) whether two or more corporations are members of the same controlled group under section 267(b)(3), a person is considered to own stock owned directly by such person, stock owned with the application of section 1563(e)(1), and stock owned with the application of section 267(c). The following examples illustrate the application of this paragraph.

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

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

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

(c)–(d) [Reserved]

(e)(1)–(4) [Reserved]

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

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

[T.D. 8209, 53 FR 22171, June 14, 1988]

§1.956–2 Definition of United States property.

(a) *Included property*—(1) *In general.* For purposes of section 956(a) and §1.956–1, United States property is (except as provided in paragraph (b) of this section) any property acquired (within the meaning of paragraph (d)(1) of this section) by a foreign corporation (whether or not a controlled foreign corporation at the time) during any taxable year of such foreign corporation beginning after December 31, 1962, which is—

(i) Tangible property (real or personal) located in the United States;

(ii) Stock of a domestic corporation;

(iii) An obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)); or

(iv) Any right to the use in the United States of—

(*a*) A patent or copyright,

(*b*) An invention, model, or design (whether or not patented),

(*c*) A secret formula or process, or

(*d*) Any other similar property right,

which is acquired or developed by the foreign corporation for use in the United States by any person. Whether a right described in this subdivision has been acquired or developed for use in the United States by any person is to be determined from all the facts and circumstances of each case. As a general rule, a right actually used principally in the United States will be considered to have been acquired or developed for use in the United States in the absence of affirmative evidence showing that the right was not so acquired or developed for such use.

(2) *Illustrations.* The application of the provisions of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses as a taxable year a fiscal year ending on June 30. Corporation R acquires on June 1, 1963, and holds on June 30, 1963, $100,000 of tangible property (not described in section 956(b)(2)) located in the United States. Corporation R's aggregate investment in United States property at the close of its taxable year ending

June 30, 1963, is zero since the property which is acquired on June 1, 1963, is not acquired during a taxable year of R Corporation beginning after December 31, 1962. Assuming no change in R Corporation's aggregate investment in United States property during its taxable year ending June 30, 1964, R Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 2. Foreign corporation S uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable year 1965. Corporation S is not a controlled foreign corporation at any time during its taxable years 1963 and 1964. Corporation S owns on December 31, 1964, $100,000 of tangible property (not described in section 956(b)(2)) located in the United States which it acquires during taxable years beginning after December 31, 1962. Corporation S's aggregate investment in United States property on December 31, 1964, is $100,000. Corporation S's current and accumulated earnings and profits (determined as provided in paragraph (b) of § 1.956–1) as of December 31, 1964, are in excess of $100,000. Assuming no change in S Corporation's aggregate investment in United States property during its taxable year 1965, S Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 3. Foreign corporation T uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable years 1963, 1964, and 1966. At December 31, 1964, T Corporation's investment in United States property is $100,000. Corporation T is not a controlled foreign corporation at any time during its taxable year 1965 in which it acquires $25,000 of tangible property (not described in section 956(b)(2)) located in the United States. On December 31, 1965, T Corporation holds the United States property of $100,000 which it held on December 31, 1964, and, in addition, the United States property acquired in 1965. Corporation T's aggregate investment in United States property at December 31, 1965, is $125,000. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of § 1.956–1) as of December 31, 1965, are in excess of $125,000, and T Corporation pays no amount during 1965 to which section 959 (c)(1) applies. Assuming no change in T Corporation's aggregate investment in United States property during its taxable year 1966, T Corporation's increase in earnings invested in United States property for such taxable year is zero.

(3) *Property owned through partnership.* For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property. This paragraph (a)(3) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

(b) *Exceptions*—(1) *Excluded property.* For purposes of section 956(a) and paragraph (a) of this section, United States property does not include the following types of property held by a foreign corporation:

(i) Obligations of the United States.

(ii) Money.

(iii) Deposits with persons carrying on the banking business, unless the deposits serve directly or indirectly as a pledge or guarantee within the meaning of paragraph (c) of this section. See paragraph (e)(2) of § 1.956–1.

(iv) Property located in the United States which is purchased in the United States for export to, or use in, foreign countries. For purposes of this subdivision, property to be used outside the United States will be considered property to be used in a foreign country. Whether property is of a type described in this subdivision is to be determined from all the facts and circumstances in each case. Property which constitutes export trade assets within the meaning of section 971(c)(2) and paragraph (c)(3) of § 1.971–1 will be considered property of a type described in this subdivision.

(v) Any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) arising in connection with the sale or processing of property if the amount of such obligation outstanding at any time during the taxable year of the foreign corporation does not exceed an amount which is ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person, or, if the sale or processing transaction occurs between related persons, would be ordinary and necessary to carry on the trade or business of both the other party to the sale

or processing transaction and the United States person if such persons were unrelated persons. Whether the amount of an obligation described in this subdivision is ordinary and necessary is to be determined from all the facts and circumstances in each case.

(vi) Any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States. Whether transportation property described in this subdivision is used in foreign commerce and predominantly outside the United States is to be determined from all the facts and circumstances in each case. As a general rule, such transportation property will be considered to be used predominantly outside the United States if 70 percent or more of the miles traversed (during the taxable year at the close of which a determination is made under section 956(a)(2)) in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year.

(vii) An amount of assets described in paragraph (a) of this section of an insurance company equivalent to the unearned premiums or reserves which are ordinary and necessary for the proper conduct of that part of its insurance business which is attributable to contracts other than those described in section 953(a)(1) and the regulations thereunder. For purposes of this subdivision, a reserve will be considered ordinary and necessary for the proper conduct of an insurance business if, under the principles of paragraph (c) of §1.953-4, such reserve would qualify as a reserve required by law. See paragraph (d)(3) of §1.954-2 for determining, for purposes of this subdivision, the meaning of insurance company and of unearned premiums.

(viii) For taxable years beginning after December 31, 1975, the voting or nonvoting stock or obligations of an unrelated domestic corporation. For purposes of this subdivision, an unrelated domestic corporation is a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation making the investment, nor a corporation 25 percent or more of whose total combined voting power of all classes of stock entitled to vote is owned or considered as owned (within the meaning of section 958 (b)) by United States shareholders of the controlled foreign corporation making the investment. The determination of whether a domestic corporation is an unrelated corporation is made immediately after each acquisition of stock or obligations by the controlled foreign corporations.

(ix) For taxable years beginning after December 31, 1975, movable drilling rigs or barges and other movable exploration and exploitation equipment (other than a vessel or an aircraft) when used on the Continental Shelf (as defined in section 638) of the United States in the exploration for, development, removal, or transportation of natural resources from or under ocean waters. Property used on the Continental Shelf includes property located in the United States which is being constructed or is in storage or in transit within the United States for use on the Continental Shelf. In general, the type of property which qualifies for the exception under this subdivision includes any movable property which would be entitled to the investment credit if used outside the United States in certain geographical areas of the Western Hemisphere pursuant to section 48(a)(2)(B)(x) (without reference to sections 49 and 50).

(x) An amount of—

(*a*) A controlled foreign corporation's assets described in paragraph (a) of this section equivalent to its earnings and profits which are accumulated after December 31, 1962, and are attributable to items of income described in section 952(b) and the regulations thereunder, reduced by the amount of

(*b*) The earnings and profits of such corporation which are applied in a taxable year of such corporation beginning after December 31, 1962, to discharge a liability on property, but only if the liability was in existence at the close of such corporation's taxable year immediately preceding its first taxable year beginning after December 31, 1962, and the property would have been United States property if it had been acquired

by such corporation immediately before such discharge.

For purposes of this subdivision, distributions made by such corporation for any taxable year shall be considered first made out of earnings and profits for such year other than earnings and profits referred to in (*a*) of this subdivision.

(2) *Statement required.* If a United States shareholder of a controlled foreign corporation excludes any property from the United States property of such controlled foreign corporation on the ground that section 956(b)(2) applies to such excluded property, he shall attach to his return a statement setting forth, by categories described in paragraph (a)(1) of this section, the amount of United States property of the controlled foreign corporation and, by categories described in subparagraph (1) of this paragraph, the amount of such property which is excluded.

(c) *Treatment of pledges and guarantees*—(1) *General rule.* Except as provided in subparagraph (4) of this paragraph, any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) with respect to which a controlled foreign corporation is a pledgor or guarantor shall be considered for purposes of section 956(a) and paragraph (a) of this section to be United States property held by such controlled foreign corporation.

(2) *Indirect pledge or guarantee.* If the assets of a controlled foreign corporation serve at any time, even though indirectly, as security for the performance of an obligation of a United States person, then, for purposes of paragraph (c)(1) of this section, the controlled foreign corporation will be considered a pledgor or guarantor of that obligation. For this purpose the pledge of stock of a controlled foreign corporation will be considered as the indirect pledge of the assets of the corporation if at least 66 2/3 percent of the total combined voting power of all classes of stock entitled to vote is pledged and if the pledge of stock is accompanied by one or more negative covenants or similar restrictions on the shareholder effectively limiting the corporation's discretion with respect to the disposition of assets and the incurrence of liabilities other than in the ordinary course of business. This paragraph (c)(2) applies only to pledges and guarantees which are made after September 8, 1980. For purposes of this paragraph (c)(2) a refinancing shall be considered as a new pledge or guarantee.

(3) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example 1. A, a United States person, borrows $100,000 from a bank in foreign country X on December 31, 1964. On the same date controlled foreign corporation R pledges its assets as security for A's performance of A's obligation to repay such loan. The place at which or manner in which A uses the money is not material. For purposes of paragraph (b) of §1.956–1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of §1.956–1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example 2. The facts are the same as in example 1, except that R Corporation participates in the transaction, not by pledging its assets as security for A's performance of A's obligation to repay the loan, but by agreeing to buy for $1,00,000 at maturity the note representing A's obligation if A does not repay the loan. Separate arrangements are made with respect to the payment of the interest on the loan. The agreement of R Corporation to buy the note constitutes a guarantee of A's obligation. For purposes of paragraph (b) of §1.956–1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of §1.956–1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example 3. A, a United States person, borrows $100,000 from a bank on December 10, 1981, pledging 70 percent of the stock of X, a controlled foreign corporation, as collateral for the loan. A and X use the calendar year as their taxable year. in the loan agreement, among other things, A agrees not to cause or permit X Corporation to do any of the following without the consent of the bank:

(a) Borrow money or pledge assets, except as to borrowings in the ordinary course of business of X Corporation;

(b) Guarantee, assume, or become liable on the obligation of another, or invest in or lend funds to another;

(c) Merge or consolidate with any other corporation or transfer shares of any controlled subsidiary;

(d) Sell or lease (other than in the ordinary course of business) or otherwise dispose of any substantial part of its assets;

(e) Pay or secure any debt owing by X Corporation to A; and

(f) Pay any dividends, except in such amounts as may be required to make interest or principal payments on A's loan from the bank.

A retains the right to vote the stock unless a default occurs by A. Under paragraph (c)(2) of this section, the assets of X Corporation serve indirectly as security for A's performance of A's obligation to repay the loan and X Corporation will be considered a pledgor or guarantor with respect to that obligation. For purposes of paragraph (b) of §1.956-1, X Corporation will be considered to hold A's obligation to repay the bank $100,000 and under paragraph (e)(2) of §1.956-1, the amount taken into account in computing X Corporation's aggregate investment in United States property on December 31, 1981, is the unpaid principal amount of the obligation on that date.

(4) *Special rule for certain conduit financing arrangements.* The rule contained in subparagraph (1) of this paragraph shall not apply to a pledge or a guarantee by a controlled foreign corporation to secure the obligation of a United States person if such United States person is a mere conduit in a financing arrangement. Whether the United States person is a mere conduit in a financing arrangement will depend upon all the facts and circumstances in each case. A United States person will be considered a mere conduit in a financing arrangement in a case in which a controlled foreign corporation pledges stock of its subsidiary corporation, which is also a controlled foreign corporation, to secure the obligation of such United States person, where the following conditions are satisfied:

(i) Such United States person is a domestic corporation which is not engaged in the active conduct of a trade or business and has no substantial assets other than those arising out of its relending of the funds borrowed by it on such obligation to the controlled foreign corporation whose stock is pledged; and

(ii) The assets of such United States person are at all times substantially offset by its obligation to the lender.

(d) *Definitions*—(1) *Meaning of "acquired"*—(i) *Applicable rules.* For purposes of this section—

(*a*) Property shall be considered acquired by a foreign corporation when such corporation acquires an adjusted basis in the property;

(*b*) Property which is an obligation of a United States person with respect to which a controlled foreign corporation is a pledgor or guarantor (within the meaning of paragraph (c) of this section) shall be considered acquired when the corporation becomes liable as a pledgor or guarantor or is otherwise considered a pledgor or guarantor (within the meaning of paragraph (c)(2) of this section); and

(*c*) Property shall not be considered acquired by a foreign corporation if—

(*1*) Such property is acquired in a transaction in which gain or loss would not be recognized under this chapter to such corporation if such corporation were a domestic corporation;

(*2*) The basis of the property acquired by the foreign corporation is the same as the basis of the property exchanged by such corporation; and

(*3*) The property exchanged by the foreign corporation was not United States property (as defined in paragraph (a)(1) of this section) but would have been such property if it had been acquired by such corporation immediately before such exchange.

(ii) *Illustrations.* The application of this subparagraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses the calendar year as a taxable year and acquires before January 1, 1963, stock of domestic corporation M having as to R Corporation an adjusted basis of $10,000. The stock of M Corporation is not United States property of R Corporation on December 31, 1962, since it is not acquired in a taxable year of R Corporation beginning on or after Janury 1, 1963. On June 30, 1963, R Corporation sells the M Corporation stock for $15,000 in cash and expends such amount in acquiring stock of domestic corporation N which has as to R Corporation an adjusted basis of $15,000. For purposes of determining R Corporation's aggregate investment in United States property on December 31, 1963, R Corporation has, by virtue of acquiring the stock of N Corporation, acquired $15,000 of United States property.

Example 2. Foreign corporation S, a controlled foreign corporation for the entire period here involved, uses the calendar year as a taxable year and purchases for $100,000 on December 31, 1963, tangible property (not described in section 956(b)(2)) located in the United States and having a remaining estimated useful life of 10 years, subject to a mortgage of $80,000 payable in 5 annual installments. The property constitutes United States property as of December 31, 1963, and the amount taken into account for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of §1.956-1 is $20,000. No depreciation is sustained with respect to the property during the taxable year 1963. During the taxable year 1964, S Corporation pays $16,000 on the mortgage and sustains $10,000 of depreciation with respect to the property. As of December 31, 1964, the amount taken into account with respect to the property for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of §1.956-1 is $26,000, computed as follows:

Cost of property		$100,000
Less: Reserve for depreciation		10,000
Adjusted basis of property		90,000
Less: Liability to which property is subject:		
Gross amount of mortgage	$80,000	
Payment during 1964	16,000	
		64,000
Amount taken into account (12–31–64)		26,000

Example 3. Controlled foreign corporation T uses the calendar year as a taxable year and acquires on December 31, 1963, $10,000 of United States property not described in section 956(b)(2); no depreciation is sustained with respect to the property during 1963. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of §1.956-1) as of December 31, 1963, are in excess of $10,000, and T Corporation's United States shareholders include in their gross income under section 951(a)(1)(B) their pro rata share of T Corporation's increase ($10,000) for 1963 in earnings invested in United States property. On January 1, 1964, T Corporation acquires an additional $10,000 of United States property not described in section 956(b)(2). Each of the two items of property has an estimated useful life of 5 years, and T Corporation sustains $4,000 of depreciation with respect to such properties during its taxable year 1964. Corporation T's current and accumulated earnings and profits as of December 31, 1964, exceed $16,000, determined as provided in paragraph (b) of §1.956-1. Corporation T pays no amounts during 1963 to which section 959(c)(1) applies. Corporation T's investment of earnings in United States property at December 31, 1964, is $16,000, and its increase for 1964 in earnings invested in United States property is $6,000.

Example 4. Foreign corporation U uses the calendar year as a taxable year and acquires before January 1, 1963, stock in domestic corporation M having as to U Corporation an adjusted basis of $10,000. On December 1, 1964, pursuant to a statutory merger described in section 368(a)(1), M Corporation merges into domestic corporation N, and U Corporation receives on such date one share of stock in N Corporation, the surviving corporation, for each share of stock it held in M Corporation. Pursuant to section 354 no gain or loss is recognized to U Corporation, and pursuant to section 358 the basis of the property received (stock of N Corporation) is the same as that of the property exchanged (stock of M Corporation). Corporation U is not considered for purposes of section 956 to have acquired United States property by reason of its receipt of the stock in N Corporation.

Example 5. The facts are the same as in example 4, except that U Corporation acquires the stock of M Corporation on February 1, 1963, rather than before January 1, 1963. For purposes of determining U Corporation's aggregate investment in United States property on December 31, 1963, U Corporation has, by virtue of acquiring the stock of M Corporation, acquired $10,000 of United States property. Corporation U pays no amount during 1963 to which section 959(c)(1) applies. The reorganization and resulting acquisition on December 1, 1964, by U Corporation of N Corporation's stock also represents an acquisition of United States property; however, assuming no other change in U Corporation's aggregate investment in United States property during 1964, U Corporation's increase for such year in earnings invested in United States property is zero.

(2) [Reserved]

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

[T.D. 6704, 29 FR 2601, Feb. 20, 1964, as amended by T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 7797, 46 FR 57675, Nov. 25, 1981; T.D. 8209, 53 FR 22171, June 14, 1988; T.D. 9008, 67 FR 48025, July 23, 2002]

§1.956-2T Definition of United States Property (temporary).

(a)–(c) [Reserved]

(d)(1) [Reserved]

(2) *Obligation defined*—(i) *Rule.* For purposes of §1.956-2 of the regulations, the term "obligation" includes any bond, note, debenture, certificate, bill

receivable, account receivable, note receivable, open account, or other indebtedness, whether or not issued at a discount and whether or not bearing interest, except that such term shall not include:

(A) Any indebtedness arising out of the involuntary conversion of property which is not United States property within the meaning of paragraph (a)(1) of §1.956–2, or

(B) Any obligation of a United States person (as defined in section 957(c)) arising in connection with the provision of services by a controlled foreign corporation to the United States person if the amount of such obligation outstanding at any time during the taxable year of the controlled foreign corporation does not exceed an amount which would be ordinary and necessary to carry on the trade or business of the controlled foreign corporation and the United States person if they were unrelated. The amount of such obligations shall be considered to be ordinary and necessary to the extent of such receivables that are paid within 60 days.

See §1.956–2(b)(1)(v) for the exclusion from United States property of obligations arising in connection with the sale or processing of property where such obligations are ordinary and necessary as to amount.

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

[T.D. 8209, 53 FR 22171, June 14, 1988]

§1.956–3T Certain trade or service receivables acquired from United States persons (temporary).

(a) *In general.* For purposes of section 956(a) and §1.956–1, the term "United States property" also includes any trade or service receivable if the trade or service receivable is acquired (directly or indirectly) after March 1, 1984, from a related person who is a United States person (as defined in section 7701(a)(30)) (hereinafter referred to as a "related United States person") and the obligor under the receivable is a United States person. A trade or service receivable described in this paragraph shall be considered to be United States property notwithstanding the exceptions (other than subparagraph (H)) contained in section 956(b)(2). The terms "trade or service receivable" and "related person" have the respective meanings given to such terms by section 864(d) and the regulations thereunder. For purposes of this section, the exception contained in §1.956–2T(d)(2)(i)(B) for short-term obligations shall not apply to service receivables described in this paragraph.

(b) *Acquisition of a trade or service receivable*—(1) *General rule.* The rules of §1.864–8T(c)(1) shall be applied to determine whether a controlled foreign corporation has acquired a trade or service receivable.

(2) *Indirect acquisitions*—(i) *Acquisition through unrelated person.* A trade or service receivable will be considered to be acquired from a related person if it is acquired from an unrelated person who acquired (directly or indirectly) such receivable from a person who is a related person to the acquiring person.

(ii) *Acquisition by nominee or pass-through entity.* A controlled foreign corporation will be considered to have acquired a trade or service receivable of a related United States person held on its behalf:

(A) By a nominee or by a partnership, simple trust, S corporation or other pass-through entity to the extent the controlled foreign corporation owns (directly or indirectly) a beneficial interest in such partnership or other pass-through entity; or

(B) By another foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding such other foreign corporation (through capital contributions or debt) is to avoid the application of section 956. *See* §1.956–1T.

The rule of this paragraph (b)(2)(ii) does not limit the application of paragraph (b)(2)(iii) of this section regarding the characterization of trade or service receivables of unrelated persons acquired pursuant to certain swap or pooling arrangements. The following examples illustrate the application of this paragraph (b)(2)(ii).

Example 1. FS1, a controlled foreign corporation with substantial accumulated earnings and profits, contributes $2,000,000 to PS, a partnership, in exchange for a 20 percent

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

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

[T.D. 7894, 48 FR 22539, May 19, 1983]

§ 1.956–1 Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property.

(a) *In general.* Section 956(a)(1) and paragraph (b) of this section provide rules for determining the amount of a controlled foreign corporation's earnings invested in United States property at the close of any taxable year. Such amount is the aggregate amount invested in United States property to the extent such amount would have constituted a dividend if it had been distributed on such date. Subject to the provisions of section 951(a)(4) and the regulations thereunder, a United States shareholder of a controlled foreign corporation is required to include in his gross income his pro rata share, as determined in accordance with paragraph (c) of this section, of the controlled foreign corporation's increase for any taxable year in earnings invested in United States property but only to the extent such share is not excludable from his gross income under the provisions of section 959(a)(2) and the regulations thereunder.

(b) *Amount of a controlled foreign corporation's investment of earnings in United States property*—(1) *Dividend limitation.* The amount of a controlled foreign corporation's earnings invested at the close of its taxable year in United States property is the aggregate amount of such property held, directly or indirectly, by such corporation at the close of its taxable year to the extent such amount would have constituted a dividend under section 316 and §§ 1.316–1 and 1.316–2 (determined after the application of section 955(a)) if it had been distributed on such closing day. For purposes of this subparagraph, the determination of whether an amount would have constituted a dividend if distributed shall be made without regard to the provisions of section 959(d) and the regulations thereunder.

(2) *Aggregate amount of United States property.* For purposes of determining an increase in earnings invested in United States property for any taxable year beginning after December 31, 1975, the aggregate amount of United States property held by a controlled foreign corporation at the close of—

(i) Any taxable year beginning after December 31, 1975, and

(ii) The last taxable year beginning before January 1, 1976 does not include stock or obligations of a domestic corporation described in section 956(b)(2)(F) or movable property described in section 956(b)(2)(G).

(3) *Treatment of earnings and profits.* For purposes of making the determination under subparagraph (1) of this paragraph as to whether an amount of investment would have constituted a dividend if distributed at the close of any taxable year of a controlled foreign corporation, earnings and profits of the controlled foreign corporation shall be

considered not to include any amounts which are attributable to—

(i) Amounts which have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 951(a)(1)(B) (or which would have been so included but for section 959(a)(2)) and have not been distributed, or

(ii)(*a*) Amounts which are included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) or would be so included under such section but for the fact that such amounts were distributed to such shareholder during the taxable year, or

(*b*) Amounts which, for any prior taxable year, have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) and have not been distributed.

The rules of this subparagraph apply only in determining the limitation on a controlled foreign corporation's increase in earnings invested in United States property. See section 959 and the regulations thereunder for limitations on the exclusion from gross income of previously taxed earnings and profits.

(4) [Reserved]

(c) *Shareholder's pro rata share of increase*—(1) *General rule.* A United States shareholder's pro rata share of a controlled foreign corporation's increase for any taxable year in earnings invested in United States property is the amount determined by subtracting the shareholder's pro rata share of—

(i) The controlled foreign corporation's earnings invested in United States property at the close of its preceding taxable year, as determined under paragraph (b) of this section, reduced by amounts paid by such corporation during such preceding taxable year to which section 959(c)(1) and the regulations thereunder apply, from his pro rata share of

(ii) The controlled foreign corporation's earnings invested in United States property at the close of its current taxable year, as determined under paragraph (b) of this section.

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

Example 1. A is a United States shareholder and direct owner of 60 percent of the only class of stock of R Corporation, a controlled foreign corporation during the entire period here involved. Both A and R Corporation use the calendar year as a taxable year. Corporation R's aggregate investment in United States property on December 31, 1964, which would constitute a dividend (as determined under paragraph (b) of this section) if distributed on such date is $150,000. During the taxable year 1964, R Corporation distributed $50,000 to which section 959(c)(1) applies. Corporation R's aggregate investment in United States property on December 31, 1965, is $250,000; and R Corporation's current and accumulated earnings and profits on such date (determined as provided in paragraph (b) of this section) are $225,000. A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property is $75,000, determined as follows:

(i) Aggregate investment in United States property on December 31, 1965		$250,000
(ii) Current and accumulated earnings and profits on December 31, 1965		225,000
(iii) Amount of earnings invested in United States property on December 31, 1965, which would constitute a dividend if distributed on such date (lesser of item (i) or item (ii))		225,000
(iv) Aggregate investment in United States property on December 31, 1964, which would constitute a dividend if distributed on such date	$150,000	
Less Amounts distributed during 1964 to which section 959(c)(1) applies	50,000	100,000
(v) R Corporation's increase for 1965 in earnings invested in United States property (item (iii) minus item (iv))		125,000
(vi) A's pro rata share of R Corporation's increase for 1965 in earnings invested in United States property (item (v) times 60 percent)		75,000

Example 2. The facts are the same as in example 1, except that R Corporation's current and accumulated earnings and profits on December 31, 1965, are $100,000 instead of $225,000. Accordingly, even through R Corporation's aggregate investment in United States property on December 31, 1965, of $250,000 exceeds the net amount ($100,000) taken into account under subparagraph (1)(i) of this paragraph as of December 31, 1964, by $150,000, there is no increase for taxable year 1965 in earnings invested in United States property because of the dividend limitation of paragraph (b)(1) of this section. Corporation R's aggregate investment in United States property on December 31, 1966, is unchanged ($250,000) Corporation R's current and accumulated earnings and profits on December 31, 1966, are $175,000, and, as a consequence, its aggregate investment in United States property which would constitute a dividend if distributed on that date is

$175,000. Corporation R pays no amount during 1965 to which section 959(c)(1) applies. Corporation R's increase for the taxable year 1966 in earnings invested in United States property is $75,000, and A's pro rata share of that amount is $45,000 ($75,000 times 60 percent).

(d) *Date and basis of determinations.* The determinations made under paragraph (c)(1)(i) of this section with respect to the close of the preceding taxable year of a controlled foreign corporation and under paragraph (c)(1)(ii) with respect to the close of the current taxable year of such controlled foreign corporation, for purposes of determining the United States shareholder's pro rata share of such corporation's increased investment of earnings in United States property for the current taxable year, shall be made as of the last day of the current taxable year of such corporation but on the basis of stock owned, within the meaning of section 958(a) and the regulations thereunder, by such United States shareholder on the last day of the current taxable year of the foreign corporation on which such corporation is a controlled foreign corporation. See the last sentence of section 956(a)(2). The application of this paragraph may be illustrated from the following example:

Example. Domestic corporation M owns 60 percent of the only class of stock of A Corporation, a controlled foreign corporation during the entire period here involved. Both M Corporation and A Corporation use the calendar year as a taxable year. Corporation A's investment of earnings in United States property at the close of the taxable year 1963 is $100,000, as determined under paragraph (b) of this section, and M Corporation includes its pro rata share of such amount ($60,000) in gross income for its taxable year 1963. On June 1, 1964, M Corporation acquires an additional 25 percent of A Corporation's outstanding stock from a person who is not a United States person as defined in section 957(d). Corporation A's investment of earnings in United States property at the close of the taxable year 1964, as determined under paragraph (b) of this section, is unchanged ($100,000). Corporation A pays no amount during 1963 to which section 959(c)(1) applies. Corporation M is not required, by reason of the acquisition in 1964 of A Corporation's stock, to include an additional amount in its gross income with respect to A Corporation's investment of earnings in United States property even though the earnings invested in United States property by A Corporation attributable to the stock acquired by M Corporation were not previously taxed. The determination made under paragraph (c)(1)(i) of this section as well as the determination made under paragraph (c)(1)(ii) of this section with respect to A Corporation's investment for 1964 of earnings in United States property are made on the basis of stock owned by M Corporation (85 percent) at the close of 1964.

(e) *Amount attributable to property*—(1) *General rule.* Except as provided in subparagraph (2) of this paragraph, for purposes of paragraph (b)(1) of this section the amount taken into account with respect to any United States property shall be its adjusted basis, as of the applicable determination date, reduced by any liability (other than a liability described in subparagraph (3) of this paragraph) to which such property is subject on such date. To be taken into account under this subparagraph, a liability must constitute a specific charge against the property involved. Thus, a liability evidenced by an open account or a liability secured only by the general credit of the controlled foreign corporation will not be taken into account. On the other hand, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item on the applicable determination date bears to the adjusted basis of all such items at such time. A liability in excess of the adjusted basis of the property which is subject to such liability shall not be taken into account for the purpose of reducing the adjusted basis of other property which is not subject to such liability.

(2) *Rule for pledges and guarantees.* For purposes of this section the amount taken into account with respect to any pledge or guarantee described in paragraph (c)(1) of §1.956–2 shall be the unpaid principal amount on the applicable determination date of the obligation with respect to which the controlled foreign corporation is a pledgor or guarantor.

(3) *Excluded charges.* For purposes of subparagraph (1) of this paragraph, a specific charge created with respect to

any item of property principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation's investment of earnings in United States property will not be recognized; whether a specific charge is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to a loan is whether the loan is from a related person, as defined in section 954 (d)(3) and paragraph (e) of § 1.954-1.

(4) *Statement required.* If for purposes of this section a United States shareholder of a controlled foreign corporation reduces the adjusted basis of property which constitutes United States property on the ground that such property is subject to a liability, he shall attach to his return a statement setting forth the adjusted basis of the property before the reduction and the amount and nature of the reduction.

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

[T.D. 6704, 29 FR 2600, Feb. 20, 1964, as amended by T.D. 6795, 30 FR 942, Jan. 29, 1965; T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 8209, 53 FR 22171, June 14, 1988]

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

(a) [Reserved]

(b)(1)-(3) [Reserved]

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

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

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

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

(c)-(d) [Reserved]

(e)(1)-(4) [Reserved]

(e)(5) *Excluded charges*—(i) *Special rule.* For purposes of § 1.956-1(e)(1) of the regulations, in the case of an investment in United States property consisting of an obligation of a related person, as defined in section 954(d)(3) and paragraph (e) of § 1.954-1, a liability will not be recognized as a specific charge if the liability representing the charge is with recourse with respect to the general credit or other assets of the investing controlled foreign corporation.

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

[T.D. 8209, 53 FR 22171, June 14, 1988]

§ 1.956-2 Definition of United States property.

(a) *Included property*—(1) *In general.* For purposes of section 956(a) and §1.956-1, United States property is (except as provided in paragraph (b) of this section) any property acquired (within the meaning of paragraph (d)(1) of this section) by a foreign corporation (whether or not a controlled foreign corporation at the time) during any taxable year of such foreign corporation beginning after December 31, 1962, which is—

(i) Tangible property (real or personal) located in the United States;

(ii) Stock of a domestic corporation;

(iii) An obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)); or

(iv) Any right to the use in the United States of—

(*a*) A patent or copyright,

(*b*) An invention, model, or design (whether or not patented),

(*c*) A secret formula or process, or

(*d*) Any other similar property right, which is acquired or developed by the foreign corporation for use in the United States by any person. Whether a right described in this subdivision has been acquired or developed for use in the United States by any person is to be determined from all the facts and circumstances of each case. As a general rule, a right actually used principally in the United States will be considered to have been acquired or developed for use in the United States in the absence of affirmative evidence showing that the right was not so acquired or developed for such use.

(2) *Illustrations.* The application of the provisions of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses as a taxable year a fiscal year ending on June 30. Corporation R acquires on June 1, 1963, and holds on June 30, 1963, $100,000 of tangible property (not described in section 956(b)(2)) located in the United States. Corporation R's aggregate investment in United States property at the close of its taxable year ending June 30, 1963, is zero since the property which is acquired on June 1, 1963, is not acquired during a taxable year of R Corporation beginning after December 31, 1962. Assuming no change in R Corporation's aggregate investment in United States property during its taxable year ending June 30, 1964, R Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 2. Foreign corporation S uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable year 1965. Corporation S is not a controlled foreign corporation at any time during its taxable years 1963 and 1964. Corporation S owns on December 31, 1964, $100,000 of tangible property (not described in section 956(b)(2)) located in the United States which it acquires during taxable years beginning after December 31, 1962. Corporation S's aggregate investment in United States property on December 31, 1964, is $100,000. Corporation S's current and accumulated earnings and profits (determined as provided in paragraph (b) of §1.956-1) as of December 31, 1964, are in excess of $100,000. Assuming no change in S Corporation's aggregate investment in United States property during its taxable year 1965, S Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 3. Foreign corporation T uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable years 1963, 1964, and 1966. At December 31, 1964, T Corporation's investment in United States property is $100,000. Corporation T is not a controlled foreign corporation at any time during its taxable year 1965 in which it acquires $25,000 of tangible property (not described in section 956(b)(2)) located in the United States. On December 31, 1965, T Corporation holds the United States property of $100,000 which it held on December 31, 1964, and, in addition, the United States property acquired in 1965. Corporation T's aggregate investment in United States property at December 31, 1965, is $125,000. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of §1.956-1) as of December 31, 1965, are in excess of $125,000, and T Corporation pays no amount during 1965 to which section 959 (c)(1) applies. Assuming no change in T Corporation's aggregate investment in United States property during its taxable year 1966, T Corporation's increase in earnings invested in United States property for such taxable year is zero.

(3) *Property owned through partnership.* For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns

property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property. This paragraph (a)(3) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

(b) *Exceptions*—(1) *Excluded property.* For purposes of section 956(a) and paragraph (a) of this section, United States property does not include the following types of property held by a foreign corporation:

(i) Obligations of the United States.

(ii) Money.

(iii) Deposits with persons carrying on the banking business, unless the deposits serve directly or indirectly as a pledge or guarantee within the meaning of paragraph (c) of this section. See paragraph (e)(2) of § 1.956–1.

(iv) Property located in the United States which is purchased in the United States for export to, or use in, foreign countries. For purposes of this subdivision, property to be used outside the United States will be considered property to be used in a foreign country. Whether property is of a type described in this subdivision is to be determined from all the facts and circumstances in each case. Property which constitutes export trade assets within the meaning of section 971(c)(2) and paragraph (c)(3) of § 1.971–1 will be considered property of a type described in this subdivision.

(v) Any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) arising in connection with the sale or processing of property if the amount of such obligation outstanding at any time during the taxable year of the foreign corporation does not exceed an amount which is ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person, or, if the sale or processing transaction occurs between related persons, would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person if such persons were unrelated persons. Whether the amount of an obligation described in this subdivision is ordinary and necessary is to be determined from all the facts and circumstances in each case.

(vi) Any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States. Whether transportation property described in this subdivision is used in foreign commerce and predominantly outside the United States is to be determined from all the facts and circumstances in each case. As a general rule, such transportation property will be considered to be used predominantly outside the United States if 70 percent or more of the miles traversed (during the taxable year at the close of which a determination is made under section 956(a)(2)) in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year.

(vii) An amount of assets described in paragraph (a) of this section of an insurance company equivalent to the unearned premiums or reserves which are ordinary and necessary for the proper conduct of that part of its insurance business which is attributable to contracts other than those described in section 953(a)(1) and the regulations thereunder. For purposes of this subdivision, a reserve will be considered ordinary and necessary for the proper conduct of an insurance business if, under the principles of paragraph (c) of § 1.953–4, such reserve would qualify as a reserve required by law. See paragraph (d)(3) of § 1.954–2 for determining, for purposes of this subdivision, the meaning of insurance company and of unearned premiums.

(viii) For taxable years beginning after December 31, 1975, the voting or nonvoting stock or obligations of an unrelated domestic corporation. For purposes of this subdivision, an unrelated domestic corporation is a domestic corporation which is neither a United States shareholder (as defined

in section 951(b)) of the controlled foreign corporation making the investment, nor a corporation 25 percent or more of whose total combined voting power of all classes of stock entitled to vote is owned or considered as owned (within the meaning of section 958 (b)) by United States shareholders of the controlled foreign corporation making the investment. The determination of whether a domestic corporation is an unrelated corporation is made immediately after each acquisition of stock or obligations by the controlled foreign corporations.

(ix) For taxable years beginning after December 31, 1975, movable drilling rigs or barges and other movable exploration and exploitation equipment (other than a vessel or an aircraft) when used on the Continental Shelf (as defined in section 638) of the United States in the exploration for, development, removal, or transportation of natural resources from or under ocean waters. Property used on the Continental Shelf includes property located in the United States which is being constructed or is in storage or in transit within the United States for use on the Continental Shelf. In general, the type of property which qualifies for the exception under this subdivision includes any movable property which would be entitled to the investment credit if used outside the United States in certain geographical areas of the Western Hemisphere pursuant to section 48(a)(2)(B)(x) (without reference to sections 49 and 50).

(x) An amount of—

(*a*) A controlled foreign corporation's assets described in paragraph (a) of this section equivalent to its earnings and profits which are accumulated after December 31, 1962, and are attributable to items of income described in section 952(b) and the regulations thereunder, reduced by the amount of

(*b*) The earnings and profits of such corporation which are applied in a taxable year of such corporation beginning after December 31, 1962, to discharge a liability on property, but only if the liability was in existence at the close of such corporation's taxable year immediately preceding its first taxable year beginning after December 31, 1962, and the property would have been United States property if it had been acquired by such corporation immediately before such discharge.

For purposes of this subdivision, distributions made by such corporation for any taxable year shall be considered first made out of earnings and profits for such year other than earnings and profits referred to in (*a*) of this subdivision.

(2) *Statement required.* If a United States shareholder of a controlled foreign corporation excludes any property from the United States property of such controlled foreign corporation on the ground that section 956(b)(2) applies to such excluded property, he shall attach to his return a statement setting forth, by categories described in paragraph (a)(1) of this section, the amount of United States property of the controlled foreign corporation and, by categories described in subparagraph (1) of this paragraph, the amount of such property which is excluded.

(c) *Treatment of pledges and guarantees*—(1) *General rule.* Except as provided in subparagraph (4) of this paragraph, any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) with respect to which a controlled foreign corporation is a pledgor or guarantor shall be considered for purposes of section 956(a) and paragraph (a) of this section to be United States property held by such controlled foreign corporation.

(2) *Indirect pledge or guarantee.* If the assets of a controlled foreign corporation serve at any time, even though indirectly, as security for the performance of an obligation of a United States person, then, for purposes of paragraph (c)(1) of this section, the controlled foreign corporation will be considered a pledgor or guarantor of that obligation. For this purpose the pledge of stock of a controlled foreign corporation will be considered as the indirect pledge of the assets of the corporation if at least 66 2/3 percent of the total combined voting power of all classes of stock entitled to vote is pledged and if the pledge of stock is accompanied by one or more negative covenants or similar restrictions on the shareholder effectively limiting the corporation's discretion with respect to

the disposition of assets and the incurrence of liabilities other than in the ordinary course of business. This paragraph (c)(2) applies only to pledges and guarantees which are made after September 8, 1980. For purposes of this paragraph (c)(2) a refinancing shall be considered as a new pledge or guarantee.

(3) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example 1. A, a United States person, borrows $100,000 from a bank in foreign country X on December 31, 1964. On the same date controlled foreign corporation R pledges its assets as security for A's performance of A's obligation to repay such loan. The place at which or manner in which A uses the money is not material. For purposes of paragraph (b) of §1.956–1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of §1.956–1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example 2. The facts are the same as in example 1, except that R Corporation participates in the transaction, not by pledging its assets as security for A's performance of A's obligation to repay the loan, but by agreeing to buy for $1,00,000 at maturity the note representing A's obligation if A does not repay the loan. Separate arrangements are made with respect to the payment of the interest on the loan. The agreement of R Corporation to buy the note constitutes a guarantee of A's obligation. For purposes of paragraph (b) of §1.956–1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of §1.956–1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example 3. A, a United States person, borrows $100,000 from a bank on December 10, 1981, pledging 70 percent of the stock of X, a controlled foreign corporation, as collateral for the loan. A and X use the calendar year as their taxable year. in the loan agreement, among other things, A agrees not to cause or permit X Corporation to do any of the following without the consent of the bank:

(a) Borrow money or pledge assets, except as to borrowings in the ordinary course of business of X Corporation;

(b) Guarantee, assume, or become liable on the obligation of another, or invest in or lend funds to another;

(c) Merge or consolidate with any other corporation or transfer shares of any controlled subsidiary;

(d) Sell or lease (other than in the ordinary course of business) or otherwise dispose of any substantial part of its assets;

(e) Pay or secure any debt owing by X Corporation to A; and

(f) Pay any dividends, except in such amounts as may be required to make interest or principal payments on A's loan from the bank.

A retains the right to vote the stock unless a default occurs by A. Under paragraph (c)(2) of this section, the assets of X Corporation serve indirectly as security for A's performance of A's obligation to repay the loan and X Corporation will be considered a pledgor or guarantor with respect to that obligation. For purposes of paragraph (b) of §1.956–1, X Corporation will be considered to hold A's obligation to repay the bank $100,000 and under paragraph (e)(2) of §1.956–1, the amount taken into account in computing X Corporation's aggregate investment in United States property on December 31, 1981, is the unpaid principal amount of the obligation on that date.

(4) *Special rule for certain conduit financing arrangements.* The rule contained in subparagraph (1) of this paragraph shall not apply to a pledge or a guarantee by a controlled foreign corporation to secure the obligation of a United States person if such United States person is a mere conduit in a financing arrangement. Whether the United States person is a mere conduit in a financing arrangement will depend upon all the facts and circumstances in each case. A United States person will be considered a mere conduit in a financing arrangement in a case in which a controlled foreign corporation pledges stock of its subsidiary corporation, which is also a controlled foreign corporation, to secure the obligation of such United States person, where the following conditions are satisfied:

(i) Such United States person is a domestic corporation which is not engaged in the active conduct of a trade or business and has no substantial assets other than those arising out of its relending of the funds borrowed by it on such obligation to the controlled foreign corporation whose stock is pledged; and

(ii) The assets of such United States person are at all times substantially offset by its obligation to the lender.

(d) *Definitions*—(1) *Meaning of "acquired"*—(i) *Applicable rules.* For purposes of this section—

(*a*) Property shall be considered acquired by a foreign corporation when such corporation acquires an adjusted basis in the property;

(*b*) Property which is an obligation of a United States person with respect to which a controlled foreign corporation is a pledgor or guarantor (within the meaning of paragraph (c) of this section) shall be considered acquired when the corporation becomes liable as a pledgor or guarantor or is otherwise considered a pledgor or guarantor (within the meaning of paragraph (c)(2) of this section); and

(*c*) Property shall not be considered acquired by a foreign corporation if—

(*1*) Such property is acquired in a transaction in which gain or loss would not be recognized under this chapter to such corporation if such corporation were a domestic corporation;

(*2*) The basis of the property acquired by the foreign corporation is the same as the basis of the property exchanged by such corporation; and

(*3*) The property exchanged by the foreign corporation was not United States property (as defined in paragraph (a)(1) of this section) but would have been such property if it had been acquired by such corporation immediately before such exchange.

(ii) *Illustrations.* The application of this subparagraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses the calendar year as a taxable year and acquires before January 1, 1963, stock of domestic corporation M having as to R Corporation an adjusted basis of $10,000. The stock of M Corporation is not United States property of R Corporation on December 31, 1962, since it is not acquired in a taxable year of R Corporation beginning on or after Janury 1, 1963. On June 30, 1963, R Corporation sells the M Corporation stock for $15,000 in cash and expends such amount in acquiring stock of domestic corporation N which has as to R Corporation an adjusted basis of $15,000. For purposes of determining R Corporation's aggregate investment in United States property on December 31, 1963, R Corporation has, by virtue of acquiring the stock of N Corporation, acquired $15,000 of United States property.

Example 2. Foreign corporation S, a controlled foreign corporation for the entire period here involved, uses the calendar year as a taxable year and purchases for $100,000 on December 31, 1963, tangible property (not described in section 956(b)(2)) located in the United States and having a remaining estimated useful life of 10 years, subject to a mortgage of $80,000 payable in 5 annual installments. The property constitutes United States property as of December 31, 1963, and the amount taken into account for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of §1.956–1 is $20,000. No depreciation is sustained with respect to the property during the taxable year 1963. During the taxable year 1964, S Corporation pays $16,000 on the mortgage and sustains $10,000 of depreciation with respect to the property. As of December 31, 1964, the amount taken into account with respect to the property for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of §1.956–1 is $26,000, computed as follows:

Cost of property		$100,000
Less: Reserve for depreciation		10,000
Adjusted basis of property		90,000
Less Liability to which property is subject		
Gross amount of mortgage	$80,000	
Payment during 1964	16,000	
		64,000
Amount taken into account (12–31–64)		26,000

Example 3. Controlled foreign corporation T uses the calendar year as a taxable year and acquires on December 31, 1963, $10,000 of United States property not described in section 956(b)(2); no depreciation is sustained with respect to the property during 1963. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of §1.956–1) as of December 31, 1963, are in excess of $10,000, and T Corporation's United States shareholders include in their gross income under section 951(a)(1)(B) their pro rata share of T Corporation's increase ($10,000) for 1963 in earnings invested in United States property. On January 1, 1964, T Corporation acquires an additional $10,000 of United States property not described in section 956(b)(2). Each of the two items of property has an estimated useful life of 5 years, and T Corporation sustains $4,000 of depreciation with respect to such properties during its taxable year 1964. Corporation T's current and accumulated earnings and profits as of December 31, 1964, exceed $16,000, determined as provided in paragraph (b) of §1.956–1. Corporation T pays no amounts during 1963 to which section 959(c)(1) applies. Corporation T's investment of earnings in United States property at December 31, 1964, is $16,000, and its increase for

1964 in earnings invested in United States property is $6,000.

Example 4. Foreign corporation U uses the calendar year as a taxable year and acquires before January 1, 1963, stock in domestic corporation M having as to U Corporation an adjusted basis of $10,000. On December 1, 1964, pursuant to a statutory merger described in section 368(a)(1), M Corporation merges into domestic corporation N, and U Corporation receives on such date one share of stock in N Corporation, the surviving corporation, for each share of stock it held in M Corporation. Pursuant to section 354 no gain or loss is recognized to U Corporation, and pursuant to section 358 the basis of the property received (stock of N Corporation) is the same as that of the property exchanged (stock of M Corporation). Corporation U is not considered for purposes of section 956 to have acquired United States property by reason of its receipt of the stock in N Corporation.

Example 5. The facts are the same as in example 4, except that U Corporation acquires the stock of M Corporation on February 1, 1963, rather than before January 1, 1963. For purposes of determining U Corporation's aggregate investment in United States property on December 31, 1963, U Corporation has, by virtue of acquiring the stock of M Corporation, acquired $10,000 of United States property. Corporation U pays no amount during 1963 to which section 959(c)(1) applies. The reorganization and resulting acquisition on December 1, 1964, by U Corporation of N Corporation's stock also represents an acquisition of United States property; however, assuming no other change in U Corporation's aggregate investment in United States property during 1964, U Corporation's increase for such year in earnings invested in United States property is zero.

(2) [Reserved]

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

[T.D. 6704, 29 FR 2601, Feb. 20, 1964, as amended by T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 7797, 46 FR 57675, Nov. 25, 1981; T.D. 8209, 53 FR 22171, June 14, 1988; T.D. 9008, 67 FR 48025, July 23, 2002]

§ 1.956-2T Definition of United States Property (temporary).

(a)–(c) [Reserved]

(d)(1) [Reserved]

(2) *Obligation defined*—(i) *Rule.* For purposes of § 1.956-2 of the regulations, the term "obligation" includes any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other indebtedness, whether or not issued at a discount and whether or not bearing interest, except that such term shall not include:

(A) Any indebtedness arising out of the involuntary conversion of property which is not United States property within the meaning of paragraph (a)(1) of § 1.956-2, or

(B) Any obligation of a United States person (as defined in section 957(c)) arising in connection with the provision of services by a controlled foreign corporation to the United States person if the amount of such obligation outstanding at any time during the taxable year of the controlled foreign corporation does not exceed an amount which would be ordinary and necessary to carry on the trade or business of the controlled foreign corporation and the United States person if they were unrelated. The amount of such obligations shall be considered to be ordinary and necessary to the extent of such receivables that are paid within 60 days.

See § 1.956-2(b)(1)(v) for the exclusion from United States property of obligations arising in connection with the sale or processing of property where such obligations are ordinary and necessary as to amount.

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

[T.D. 8209, 53 FR 22171, June 14, 1988]

§ 1.956-3T Certain trade or service receivables acquired from United States persons (temporary).

(a) *In general.* For purposes of section 956(a) and § 1.956-1, the term "United States property" also includes any trade or service receivable if the trade or service receivable is acquired (directly or indirectly) after March 1, 1984, from a related person who is a United States person (as defined in section 7701(a)(30)) (hereinafter referred to as a "related United States person") and the obligor under the receivable is a United States person. A trade or service receivable described in this paragraph shall be considered to be United States property notwithstanding the exceptions (other than subparagraph (H)) contained in section 956(b)(2). The terms "trade or service receivable" and "related person" have

CERTIFICATE OF SERVICE

I hereby certify that, on November 14, 2018, (i) the foregoing brief was electronically filed with the Clerk of the Court for the United States Court of Appeals for the Third Circuit by using the appellate CM/ECF system, and (ii) seven paper copies of the brief were sent to the Clerk by First Class Mail. I further certify that all participants in this case are registered CM/ECF users and that service will be accomplished by this Court's CM/ECF system.

/s/ Judith A. Hagley
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