

a chain of three foreign corporations. In such case, assuming that the Z Corporation is a foreign personal holding company for a taxable year ending with or within the taxable year of the Y Corporation, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation for the purpose of determining whether the Y Corporation comes within the classification of a foreign personal holding company. If, after the inclusion of such presumptive dividend, the Y Corporation is a foreign personal holding company, the undistributed foreign personal holding company income of the Z Corporation would be included in the gross income of the Y Corporation in determining the undistributed foreign personal holding company income of the Y Corporation which is includible in the gross income of its shareholder, the X Corporation. The same process would be repeated with respect to determining whether the X Corporation is a foreign personal holding company and in determining its undistributed foreign personal holding company income. If all three corporations are foreign personal holding companies, the undistributed foreign personal holding company income of each would, in this manner, be reflected as a dividend in the gross income of A, the ultimate beneficial shareholder of the chain. In the event that after the inclusion of the undistributed foreign personal holding company income of the Z Corporation in the gross income of the Y Corporation, the Y Corporation is not a foreign personal holding company, then no part of the income of either the Z Corporation or the Y Corporation would be includible in the gross income of the X Corporation. In that event, whether the X Corporation is a foreign personal holding company, and its undistributed foreign personal holding company income, would be determined independently of the income of the Y Corporation and the Z Corporation.

§ 1.556-1 Definition.

Undistributed foreign personal holding company income is the amount which is to be included in the gross income of the United States shareholders under section 551(b) and § 1.551-2. Undistributed foreign personal holding company income is the taxable income of the foreign personal holding company, as defined in section 63(a) (computed without regard to subchapter N, chapter 1 of the Code), and adjusted in the manner described in section 556(b) and § 1.556-2, less the deduction for dividends paid (§§ 1.561-1 through 1.565-6). See § 1.556-3 for an illustration of the

computation of undistributed foreign personal holding company income.

§ 1.556-2 Adjustments to taxable income.

(a) *Taxes*—(1) *General rule.* (i) In computing undistributed foreign personal holding company income for any taxable year, there shall be allowed as a deduction the Federal income and excess profits taxes accrued during the taxable year except that no deduction shall be allowed for (a) the accumulated earnings tax imposed by section 531 (or a corresponding section of a prior law), (b) the personal holding company tax imposed by section 541 (or a corresponding section of a prior law), and (c) the excess profits tax imposed by subchapter E, chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940. The deduction is for taxes for the taxable year determined under the accrual method of accounting, regardless of whether the corporation uses an accrual method of accounting, the cash receipts and disbursements method, or any other allowable method of accounting. In computing the amount of taxes accrued, an unpaid tax which is being contested is not considered accrued until the contest is resolved.

(ii) However, the corporation shall deduct taxes paid, rather than taxes accrued, if it used that method with respect to Federal taxes for each taxable year for which it was subject to the provisions of supplement P, subchapter C, chapter 1 of the Internal Revenue Code of 1939, unless an election is made under subparagraph (2) of this paragraph to deduct taxes accrued.

(2) *Election by corporation which deducted taxes paid.* (i) If the corporation was subject to supplement P, subchapter C, chapter 1 of the Internal Revenue Code of 1939, and, for the purpose of computing undistributed supplement P net income under such Code, deducted Federal taxes paid, rather than such taxes accrued, for each taxable year for which it was subject to supplement P of the 1939 Code, the corporation may elect for any taxable year ending after August 16, 1954, to deduct taxes accrued, rather than taxes paid, for the purpose of computing its undistributed foreign personal holding