

§ 1.954-0

26 CFR Ch. I (4-1-04 Edition)

§ 1.954-0 Introduction.

(a) *Effective dates*—(1) *Final regulations*—(i) *In general*. Except as otherwise specifically provided, the provisions of §§ 1.954-1 and 1.954-2 apply to taxable years of a controlled foreign corporation beginning after November 6, 1995. If any of the rules described in §§ 1.954-1 and 1.954-2 are inconsistent with provisions of other regulations under subpart F, these final regulations are intended to apply instead of such other regulations.

(ii) *Election to apply final regulations retroactively*—(A) *Scope of election*. An election may be made to apply the final regulations retroactively with respect to any taxable year of the controlled foreign corporation beginning on or after January 1, 1987. If such an election is made, these final regulations must be applied in their entirety for such taxable year and all subsequent taxable years. All references to section 11 in the final regulations shall be deemed to include section 15, where applicable.

(B) *Manner of making election*. An election under this paragraph (a)(1)(ii) is binding on all United States shareholders of the controlled foreign corporation and must be made—

(1) By the controlling United States shareholders, as defined in § 1.964-1(c)(5), by attaching a statement to such effect with their original or amended income tax returns for the taxable year of such United States shareholders in which or with which the taxable year of the CFC ends, and including any additional information required by applicable administrative pronouncements, or

(2) In such other manner as may be prescribed in applicable administrative pronouncements.

(C) *Time for making election*. An election may be made under this paragraph (a)(1)(ii) with respect to a taxable year of the controlled foreign corporation beginning on or after January 1, 1987 only if the time for filing a return or claim for refund has not expired for the taxable year of any United States shareholder of the controlled foreign corporation in which or with which such taxable year of the controlled foreign corporation ends.

(D) *Revocation of election*. An election made under this paragraph (a)(1)(ii) may not be revoked.

(2) *Temporary regulations*. The provisions of §§ 4.954-1 and 4.954-2 of this chapter apply to taxable years of a controlled foreign corporation beginning after December 31, 1986 and on or before November 6, 1995. However, the provisions of § 4.954-2(b)(6) of this chapter continue to apply. For transactions entered into on or before October 10, 1995, taxpayers may rely on Notice 89-90, 1989-2 C.B. 407, in applying the temporary regulations.

(3) *§§ 1.954A-1 and 1.954A-2*. The provisions of §§ 1.954A-1 and 1.954A-2 (as contained in 26 CFR part 1 edition revised April 1, 1995) apply to taxable years of a controlled foreign corporation beginning before January 1, 1987. All references therein to sections of the Code are to the Internal Revenue Code of 1954 prior to the amendments made by the Tax Reform Act of 1986.

(b) *Outline of §§ 1.954-0, 1.954-1 and 1.954-2.*

§ 1.954-0 Introduction.

- (a) Effective dates.
 - (1) Final regulations.
 - (i) In general.
 - (ii) Election to apply final regulations retroactively.
 - (A) Scope of election.
 - (B) Manner of making election.
 - (C) Time for making election.
 - (D) Revocation of election.
 - (2) Temporary regulations.
 - (3) §§ 1.954A-1 and 1.954A-2.
 - (b) Outline of §§ 1.954-0, 1.954-1, and 1.954-2.

§ 1.954-1 Foreign base company income.

- (a) In general.
 - (1) Purpose and scope.
 - (2) Gross foreign base company income.
 - (3) Adjusted gross foreign base company income.
 - (4) Net foreign base company income.
 - (5) Adjusted net foreign base company income.
 - (6) Insurance income.
 - (7) Additional items of adjusted net foreign base company income or adjusted net insurance income by reason of section 952(c).
 - (b) Computation of adjusted gross foreign base company income and adjusted gross insurance income.
 - (1) De minimis and full inclusion tests.
 - (i) De minimis test.
 - (A) In general.
 - (B) Currency translation.

Internal Revenue Service, Treasury

§ 1.954-0

- (C) Coordination with sections 864(d) and 881(c).
 - (i) Seventy percent full inclusion test.
 - (2) Character of gross income included in adjusted gross foreign base company income.
 - (3) Coordination with section 952(c).
 - (4) Anti-abuse rule.
 - (i) In general.
 - (ii) Presumption.
 - (iii) Related persons.
 - (iv) Example.
 - (c) Computation of net foreign base company income.
 - (1) General rule.
 - (i) Deductions against gross foreign base company income.
 - (ii) Losses reduce subpart F income by operation of earnings and profits limitation.
 - (iii) Items of income.
 - (A) Income other than passive foreign personal holding company income.
 - (B) Passive foreign personal holding company income.
 - (2) Computation of net foreign base company income derived from same country insurance income.
 - (d) Computation of adjusted net foreign base company income or adjusted net insurance income.
 - (1) Application of high tax exception.
 - (2) Effective rate at which taxes are imposed.
 - (3) Taxes paid or accrued with respect to an item of income.
 - (i) Income other than passive foreign personal holding company income.
 - (ii) Passive foreign personal holding company income.
 - (4) Special rules.
 - (i) Consistency rule.
 - (ii) Coordination with earnings and profits limitation.
 - (iii) Example.
 - (5) Procedure.
 - (6) Coordination of full inclusion and high tax exception rules.
 - (7) Examples.
 - (e) Character of income.
 - (1) Substance of the transaction.
 - (2) Separable character.
 - (3) Predominant character.
 - (4) Coordination of categories of gross foreign base company income or gross insurance income.
 - (i) In general.
 - (ii) Income excluded from other categories of gross foreign base company income.
 - (f) Definition of related person.
 - (1) Persons related to controlled foreign corporation.
 - (i) Individuals.
 - (ii) Other persons.
 - (2) Control.
 - (i) Corporations.
 - (ii) Partnerships.
 - (iii) Trusts and estates.
 - (iv) Direct or indirect ownership.

§ 1.954-2 Foreign personal holding company income.

- (a) Computation of foreign personal holding company income.
 - (1) Categories of foreign personal holding company income.
 - (2) Coordination of overlapping categories under foreign personal holding company provisions.
 - (i) In general.
 - (ii) Priority of categories.
 - (3) Changes in the use or purpose for which property is held.
 - (i) In general.
 - (ii) Special rules.
 - (A) Anti-abuse rule.
 - (B) Hedging transactions.
 - (iii) Example.
 - (4) Definitions and special rules.
 - (i) Interest.
 - (ii) Bona fide hedging transaction.
 - (A) Definition.
 - (B) Identification.
 - (C) Effect of identification and non-identification.
 - (1) Transactions identified.
 - (2) Inadvertent identification.
 - (3) Transactions not identified.
 - (4) Inadvertent error.
 - (5) Anti-abuse rule.
 - (iii) Inventory and similar property.
 - (A) Definition.
 - (B) Hedging transactions.
 - (iv) Regular dealer.
 - (v) Dealer property.
 - (A) Definition.
 - (B) Securities dealers.
 - (C) Hedging transactions.
 - (vi) Examples.
 - (vii) Debt instrument.
 - (b) Dividends, interest, rents, royalties and annuities.
 - (1) In general.
 - (2) Exclusion of certain export financing interest.
 - (i) In general.
 - (ii) Exceptions.
 - (iii) Conduct of a banking business.
 - (iv) Examples.
 - (3) Treatment of tax-exempt interest. [Reserved]
 - (4) Exclusion of dividends or interest from related persons.
 - (i) In general.
 - (A) Corporate payor.
 - (B) Payment by a partnership.
 - (ii) Exceptions.
 - (A) Dividends.
 - (B) Interest paid out of adjusted foreign base company income or insurance income.
 - (1) In general.
 - (2) Rule for corporations that are both recipients and payors of interest.
- (C) Coordination with sections 864(d) and 881(c).
 - (iii) Trade or business requirement.

- (iv) Substantial assets test.
- (v) Valuation of assets.
- (vi) Location of tangible property.
 - (A) In general.
 - (B) Exception.
- (vii) Location of intangible property.
 - (A) In general.
 - (B) Exception for property located in part in the payor's country of incorporation.
- (viii) Location of inventory and dealer property.
 - (A) In general.
 - (B) Inventory and dealer property located in part in the payor's country of incorporation.
- (ix) Location of debt instruments.
- (x) Treatment of certain stock interests.
- (xi) Treatment of banks and insurance companies. [Reserved]
- (5) Exclusion of rents and royalties derived from related persons.
 - (i) In general.
 - (A) Corporate payor.
 - (B) Payment by a partnership.
 - (ii) Exceptions.
 - (A) Rents or royalties paid out of adjusted foreign base company income or insurance income.
 - (B) Property used in part in the controlled foreign corporation's country of incorporation.
- (6) Exclusion of rents and royalties derived in the active conduct of a trade or business.
 - (c) Excluded rents.
 - (1) Active conduct of a trade or business.
 - (2) Special rules.
 - (i) Adding substantial value.
 - (ii) Substantiality of foreign organization.
 - (iii) Active leasing expenses.
 - (iv) Adjusted leasing profit.
 - (3) Examples.
 - (d) Excluded royalties.
 - (1) Active conduct of a trade or business.
 - (2) Special rules.
 - (i) Adding substantial value.
 - (ii) Substantiality of foreign organization.
 - (iii) Active licensing expenses.
 - (iv) Adjusted licensing profit.
 - (3) Examples.
 - (e) Certain property transactions.
 - (1) In general.
 - (i) Inclusions.
 - (ii) Exceptions.
 - (iii) Treatment of losses.
 - (iv) Dual character property.
 - (2) Property that gives rise to certain income.
 - (i) In general.
 - (ii) Gain or loss from the disposition of a debt instrument.
 - (3) Property that does not give rise to income.
 - (f) Commodities transactions.
 - (1) In general.
 - (i) Inclusion in foreign personal holding company income.
 - (ii) Exception.
- (iii) Treatment of losses.
- (2) Definitions.
 - (i) Commodity.
 - (ii) Commodities transaction.
 - (iii) Qualified active sale.
 - (A) In general.
 - (B) Active conduct of a commodities business.
 - (C) Substantially all.
 - (D) Activities of employees of a related entity.
 - (iv) Qualified hedging transaction entered into prior to January 31, 2003.
 - (A) In general.
 - (B) Exception.
 - (C) Effective date.
 - (v) Qualified hedging transaction entered into on or after January 31, 2003.
 - (A) In general.
 - (B) Exception.
 - (C) Examples.
 - (D) Effective date.
 - (vi) Financial institutions not a producer, etc.
 - (g) Foreign currency gain or loss.
 - (1) Scope and purpose.
 - (2) In general.
 - (i) Inclusion.
 - (ii) Exclusion for business needs.
 - (A) General rule.
 - (B) Business needs.
 - (C) Regular dealers.
 - (1) General rule.
 - (2) Certain interest-bearing liabilities treated as dealer property.
 - (i) In general.
 - (ii) Failure to identify certain liabilities.
 - (iii) Effective date.
 - (D) Example.
 - (iii) Special rule for foreign currency gain or loss from an interest-bearing liability.
 - (3) Election to characterize foreign currency gain or loss that arises from a specific category of subpart F income as gain or loss in that category.
 - (i) In general.
 - (ii) Time and manner of election.
 - (iii) Revocation of election.
 - (iv) Example.
 - (4) Election to treat all foreign currency gains or losses as foreign personal holding company income.
 - (i) In general.
 - (ii) Time and manner of election.
 - (iii) Revocation of election.
 - (5) Gains and losses not subject to this paragraph.
 - (i) Capital gains and losses.
 - (ii) Income not subject to section 988.
 - (iii) Qualified business units using the dollar approximate separate transactions method.
 - (iv) Gain or loss allocated under § 1.861-9.
 - [Reserved]
 - (h) Income equivalent to interest.
 - (1) In general.

- (i) Inclusion in foreign personal holding company income.
- (ii) Exceptions.
 - (A) Liability hedging transactions.
 - (B) Interest.
- (2) Definition of income equivalent to interest.
 - (i) In general.
 - (ii) Income from the sale of property.
- (3) Notional principal contracts.
 - (i) In general.
 - (ii) Regular dealers.
- (4) Income equivalent to interest from factoring.
 - (i) General rule.
 - (ii) Exceptions.
 - (iii) Factored receivable.
 - (iv) Examples.
- (5) Receivables arising from performance of services.
- (6) Examples.

[T.D. 8618, 60 FR 46508, Sept. 7, 1995; T.D. 8618, 60 FR 62024, Dec. 4, 1995; T.D. 8767, 63 FR 14615, Mar. 26, 1998; T.D. 9039, 68 FR 4917, Jan. 31, 2003]

§ 1.954-1 Foreign base company income.

(a) *In general*—(1) *Purpose and scope.* Section 954 and §§ 1.954-1 and 1.954-2 provide rules for computing the foreign base company income of a controlled foreign corporation. Foreign base company income is included in the subpart F income of a controlled foreign corporation under the rules of section 952. Subpart F income is included in the gross income of a United States shareholder of a controlled foreign corporation under the rules of section 951 and thus is subject to current taxation under section 1, 11 or 55 of the Internal Revenue Code. The determination of whether a foreign corporation is a controlled foreign corporation, the subpart F income of which is included currently in the gross income of its United States shareholders, is made under the rules of section 957.

(2) *Gross foreign base company income.* The gross foreign base company income of a controlled foreign corporation consists of the following categories of gross income (determined after the application of section 952(b))—

- (i) Foreign personal holding company income, as defined in section 954(c);
- (ii) Foreign base company sales income, as defined in section 954(d);
- (iii) Foreign base company services income, as defined in section 954(e);

- (iv) Foreign base company shipping income, as defined in section 954(f); and
- (v) Foreign base company oil related income, as defined in section 954(g).

(3) *Adjusted gross foreign base company income.* The term *adjusted gross foreign base company income* means the gross foreign base company income of a controlled foreign corporation as adjusted by the de minimis and full inclusion rules of paragraph (b) of this section.

(4) *Net foreign base company income.* The term *net foreign base company income* means the adjusted gross foreign base company income of a controlled foreign corporation reduced so as to take account of deductions (including taxes) properly allocable or apportionable to such income under the rules of section 954(b)(5) and paragraph (c) of this section.

(5) *Adjusted net foreign base company income.* The term *adjusted net foreign base company income* means the net foreign base company income of a controlled foreign corporation reduced, first, by any items of net foreign base company income excluded from subpart F income pursuant to section 952(c) and, second, by any items excluded from subpart F income pursuant to the high tax exception of section 954(b). See paragraph (d)(4)(ii) of this section. The term *foreign base company income* as used in the Internal Revenue Code and elsewhere in the Income Tax Regulations means adjusted net foreign base company income, unless otherwise provided.

(6) *Insurance income.* The term *gross insurance income* includes all gross income taken into account in determining insurance income under section 953. The term *adjusted gross insurance income* means gross insurance income as adjusted by the de minimis and full inclusion rules of paragraph (b) of this section. The term *net insurance income* means adjusted gross insurance income reduced under section 953 so as to take into account deductions (including taxes) properly allocable or apportionable to such income. The term *adjusted net insurance income* means net insurance income reduced by any items of net insurance income