

Paragraph 6009(a)—Green Federal Airways
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G-8 [Revised]

From Shemya, AK, NDB, 20 AGL Adak, AK, NDB; 20 AGL Dutch Harbor, AK, NDB; 20 AGL INT Dutch Harbor NDB 041° and Elfee, AK, NDB 253° bearings; 20 AGL Elfee NDB; 20 AGL Saldo, AK, NDB; INT Saldo NDB 054° and Kachemak, AK, NDB 269° bearings, to Kachemak NDB. From Campbell Lake, AK, NDB; INT Campbell Lake NDB 032°T(006°M) and Glenallen, AK, NDB 253°T(227°M) bearings; Glenallen NDB; INT Glenallen NDB 052° and Nabesna, AK, NDB 252° bearings; Nabesna NDB.
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Paragraph 6010(b)—Alaskan VOR Federal Airways
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V-328 [Revised]

From Dillingham, AK; to Kipnuk, AK.
* * * * *
Issued in Washington, DC, on August 25, 1995.

Harold W. Becker,
Manager, Airspace-Rules and Aeronautical Information Division.
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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[INTL-0075-92]

RIN 1545-AR31

Definition of Foreign Base Company Income and Foreign Personal Holding Company Income of a Controlled Foreign Corporation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed Income Tax Regulations relating to the definitions of subpart F income and foreign personal holding company income of a controlled foreign corporation and the allocation of deficits for purposes of computing the deemed-paid foreign tax credit. These proposed regulations are necessary to provide guidance that coordinates with guidance provided in final regulations under section 954, published elsewhere in this issue of the **Federal Register**. These regulations will affect United States shareholders of controlled foreign corporations. This document also contains a notice of hearing on these regulations.

DATES: Written comments must be received by December 6, 1995. Outlines of topics to be discussed at the public hearing scheduled for January 4, 1996 at 10 a.m. must be received by December 14, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (INTL-0075-92), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (INTL-0075-92), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington DC. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Valerie Mark, (202) 622-3840; concerning submissions and the hearing, Michael Slaughter (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

This notice of proposed rulemaking does not contain collections of information and, therefore, it has not been submitted to the Office of Management and Budget for review under the Paperwork Reduction Act (44 U.S.C. 3504(h)).

Background

This document contains proposed regulations amending the Income Tax Regulations (26 CFR Part 1) under sections 952, 954(c) and 960 of the Internal Revenue Code. These regulations are also issued under authority contained in section 7805 of the Internal Revenue Code. In final regulations under section 954, published elsewhere in this issue of the **Federal Register**, the section relating to the treatment of tax-exempt interest under the foreign personal holding company income rules was reserved. These proposed regulations would provide rules for the treatment of tax-exempt interest and would also provide guidance under sections 952 and 960 to coordinate with the final regulations.

Explanation of Provisions

Sections 1.952-1 (e) and (f) and 1.960-1(i)

Section 1.954-1(c)(1)(ii), published elsewhere in this issue of the **Federal Register**, provides generally that if the amount in any category of foreign base company income or foreign personal holding company income is less than

zero, the loss may not reduce any other category of foreign base company income or foreign personal holding company income except by operation of the earnings and profits limitation of section 952(c)(1). The earnings and profits limitation will apply when subpart F income exceeds current earnings and profits. This notice of proposed rulemaking provides rules under section 952(c)(1)(A) to determine how the excess of subpart F income over current earnings and profits will reduce categories of foreign base company income or foreign personal holding company income.

These rules apply both to determine the amount that is included in the U.S. shareholder's gross income in each category of subpart F income under section 951(a)(1)(A) from each section 904(d) separate category, and to determine the subpart F category and the section 904(d) separate category from which an amount will be recharacterized as subpart F income under section 952(c)(2). Separate rules are provided in this notice of proposed rulemaking to compute post-1986 undistributed earnings under section 960.

Section 1.952-1(e) provides that for post-1986 years, when the subpart F income of a controlled foreign corporation exceeds its current earnings and profits, this excess, first, proportionately reduces subpart F income in each separate category in which current earnings and profits are zero or less than zero, second, proportionately reduces subpart F income in each separate category in which subpart F income exceeds current earnings and profits, and third, proportionately reduces subpart F income in other separate categories. If a single separate category contains more than one category of subpart F income, the categories of subpart F income in the separate category will be proportionately reduced.

Section 1.952-1(f) provides that the amount and category of subpart F income in each separate category that is reduced by operation of the earnings and profits limitation, as determined under paragraph (e), constitutes a recapture account. In any year in which earnings and profits exceed subpart F income, the recapture accounts in each separate category of the corporation will be recharacterized, on a proportionate basis, as subpart F income to the extent of this excess. An amount that is recharacterized as subpart F income is treated as income in the same separate category as the recapture account from which it was derived.

Under paragraph (f), a recapture account is reduced either when amounts in the account are recharacterized as subpart F income or when the corporation makes an actual distribution from the separate category containing the recapture account. A distribution out of section 959(c)(3) earnings and profits is treated as made first on a proportionate basis out of the recapture accounts in each separate category. If a distribution from earnings and profits described in section 959(c)(3) occurs in the same year that an amount is recharacterized, the recharacterization rules will apply first. Examples are provided to illustrate the rules of paragraphs (e) and (f).

Regulations are proposed under section 960 that apply the principles of section 902 to determine the portion of the controlled foreign corporation's post-1986 foreign income taxes deemed to be paid by a United States corporate shareholder in connection with a subpart F inclusion. If the corporate shareholder computes an amount under both sections 902 and 960 for a taxable year, section 960 is applied first.

These proposed regulations also provide rules to determine how deficits in post-1986 undistributed earnings are allocated for purposes of sections 902 and 960. In accordance with the approach of Notice 88-70 (1988-2 C.B. 369), § 1.960-1(i)(4) provides that a post-1986 accumulated deficit in a separate category is allocated pro rata against post-1986 undistributed earnings in other separate categories to compute post-1986 undistributed earnings. The deficit does not permanently reduce earnings in these other separate categories. Rather, after deemed-paid taxes are computed, it is carried forward in the same separate category in which it was incurred. Paragraph (i)(3) clarifies that the numerator of the deemed-paid credit fraction cannot exceed the denominator because deemed-paid taxes may not exceed taxes paid or accrued by the controlled foreign corporation. Examples are provided to illustrate these rules.

The proposed regulations attempt to coordinate, to the extent possible, the allocation of deficits for purposes of determining the amounts of subpart F inclusions and deemed-paid taxes out of the controlled foreign corporation's separate foreign tax credit limitation categories under sections 952, 954, and 960. Complete coordination is not possible in all cases, because subpart F income and the earnings and profits limitation of section 952(c)(1)(A) are determined on the basis of earnings and profits of only the current year, whereas

deemed-paid taxes are calculated under section 960 on the basis of multi-year pools of earnings and profits and taxes. In addition, potential differences in the calculation of income and earnings and profits, cf. section 952(c)(3), complicate the coordination.

The proposed rules attempt to minimize the incidence of subpart F inclusions out of separate categories with no current earnings which, in the absence of sufficient accumulated earnings, may carry no deemed-paid taxes. Comments are requested as to whether the proposed allocation methods or some alternative approach would best achieve appropriate foreign tax credit results.

Section 1.954-2(b)(3)

Under § 1.954-2T(b)(6), interest income that is exempt from tax under section 103 is included in the foreign personal holding company income of the controlled foreign corporation. However, the net foreign base company income that is attributable to tax-exempt interest is treated as tax-exempt interest in the hands of the United States shareholder upon a deemed distribution under subpart F. Therefore, for regular tax purposes, the tax-exempt interest is not currently included in the gross income of the United States shareholder under subpart F. However, the deemed distribution of tax-exempt interest may subject the United States shareholder to the alternative minimum tax.

Section 1.954-2(b)(3) of the proposed regulations would amend the rule in the temporary regulations to provide that foreign personal holding company income includes interest income that is exempt from tax under section 103. The tax-exempt interest would not retain its character as such in the hands of the United States shareholder upon a deemed distribution under subpart F. This proposed rule closely parallels the domestic rule for tax-exempt interest. The controlled foreign corporation realizes the tax benefit associated with the receipt of interest income described in section 103 because no United States withholding tax is collected on the income when it is paid to the controlled foreign corporation. As in the domestic context, however, this tax benefit is limited to the corporate level and is not retained when the tax-exempt interest is distributed to the United States shareholders or included in their gross income under subpart F. This rule simplifies the interaction of the tax-exempt interest and alternative minimum tax provisions, and avoids the double-taxation and administrative problems associated with the current rule.

These regulations are proposed to be effective for taxable years of the foreign corporation beginning after 60 days after the date these regulations are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (signed original and eight (8) copies) that are timely submitted to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 4, 1996, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW., Washington DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments by December 6, 1995 and submit an outline of topics to be discussed and time to be devoted to each topic (signed original and eight (8) copies) by December 14, 1995.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information. The principal authors of these regulations are Barbara Felker and Valerie Mark of the Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority for Part 1 is amended by adding the following citation in numerical order to read as follows:

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

Section 1.960-1 also issued under 26 U.S.C. 960(a). * * *

Par. 2. Section 1.952-1 is amended by adding paragraphs (e) and (f) to read as follows:

§ 1.952-1 Subpart F income defined.

* * * * *

(e) *Application of current earnings and profits limitation*—(1) *In general.* If the subpart F income (as defined in section 952(a)) of a controlled foreign corporation exceeds the foreign corporation's earnings and profits for the taxable year, the subpart F income includible in the income of the corporation's United States shareholders is reduced under section 952(c)(1)(A) in accordance with the following rules. The excess of subpart F income over current year earnings and profits shall—

(i) First, proportionately reduce subpart F income in each separate category of the controlled foreign corporation, as defined in § 1.904-5(a)(1), in which current earnings and profits are zero or less than zero;

(ii) Second, proportionately reduce subpart F income in each separate category in which subpart F income exceeds current earnings and profits; and

(iii) Third, proportionately reduce subpart F income in other separate categories.

(2) *Allocation to a category of subpart F income.* An excess amount that is allocated under paragraph (e)(1) of this section to a separate category must be further allocated to a category of subpart F income if the separate category contains more than one category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954-1(c)(1)(iii)(A) (1) or (2). In such case, the excess amount that is allocated to the separate category must be allocated to the various categories of subpart F income within that separate category on a proportionate basis.

(3) *Recapture of subpart F income reduced by operation of earnings and*

profits limitation. Any amount in a category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954-1(c)(1)(iii)(A) (1) or (2) that is reduced by operation of the current year earnings and profits limitation of section 952(c)(1)(A) and this paragraph (e) shall be subject to recapture in a subsequent year under the rules of section 952(c)(2) and paragraph (f) of this section.

(4) *Coordination with sections 953 and 954.* The rules of this paragraph (e) shall be applied after the application of sections 953 and 954 and the regulations under those sections, except as provided in § 1.954-1(d)(4)(ii).

(5) *Earnings and deficits retain separate limitation character.* The income reduction rules of paragraph (e)(1) of this section shall apply only for purposes of determining the amount of an inclusion under section 951(a)(1)(A) from each separate category as defined in § 1.904-5(a)(1) and the separate categories in which recapture accounts are established under section 952(c)(2) and paragraph (f) of this section. For rules applicable in computing post-1986 undistributed earnings, see generally section 902 and the regulations under that section. For rules relating to the allocation of deficits for purposes of computing foreign taxes deemed paid under section 960 with respect to an inclusion under section 951(a)(1)(A), see § 1.960-1(i).

(f) *Recapture of subpart F income in subsequent taxable year*—(1) *In general.* If a controlled foreign corporation's subpart F income for a taxable year is reduced under the current year earnings and profits limitation of section 952(c)(1)(A) and paragraph (e) of this section, recapture accounts will be established and subject to recharacterization in any subsequent taxable year to the extent the recapture accounts were not previously recharacterized or distributed, as provided in paragraphs (f) (2) and (3) of this section.

(2) *Rules of recapture*—(i) *Recapture account.* If a category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954-1(c)(1)(iii)(A) (1) or (2) is reduced under the current year earnings and profits limitation of section 952(c)(1)(A) and paragraph (e) of this section for a taxable year, the amount of such reduction shall constitute a recapture account.

(ii) *Recapture.* Each recapture account of the controlled foreign corporation will be recharacterized, on a proportionate basis, as subpart F income in the same separate category (as

defined in § 1.904-5(a)(1)) as the recapture account to the extent that current year earnings and profits exceed subpart F income in a taxable year. The United States shareholder must include his pro rata share (determined under the rules of § 1.951-1(e)) of each recharacterized amount in income as subpart F income in such separate category for the taxable year.

(iii) *Reduction of recapture account and corresponding earnings.* Each recapture account, and post-1986 undistributed earnings in the separate category containing the recapture account, will be reduced in any taxable year by the amount which is recharacterized under paragraph (f)(2)(ii) of this section. In addition, each recapture account, and post-1986 undistributed earnings in the separate category containing the recapture account, will be reduced in the amount of any distribution out of that account (as determined under the ordering rules of section 959(c) and paragraph (f)(3)(ii) of this section).

(3) *Distribution ordering rules*—(i) *Coordination of recapture and distribution rules.* If a controlled foreign corporation distributes an amount out of earnings and profits described in section 959(c)(3) in a year in which current year earnings and profits exceed subpart F income and there is an amount in a recapture account for such year, the recapture rules will apply first.

(ii) *Distributions reduce recapture accounts first.* Any distribution made by a controlled foreign corporation out of earnings and profits described in section 959(c)(3) shall be treated as made first on a proportionate basis out of the recapture accounts in each separate category to the extent thereof (even if the amount in the recapture account exceeds post-1986 undistributed earnings in the separate category containing the recapture account). Any remaining distribution shall be treated as made on a proportionate basis out of the remaining earnings and profits of the controlled foreign corporation in each separate category. See section 904(d)(3)(D).

(4) *Examples.* The application of paragraphs (e) and (f) of this section may be illustrated by the following examples:

Example 1. (i) *A*, a U.S. person, is the sole shareholder of *CFC*, a controlled foreign corporation formed on January 1, 1996, whose functional currency is the *u*. In 1996, *CFC* earns 100u of foreign base company sales income that is general limitation income described in section 904(d)(1)(I) and incurs a (200u) loss attributable to activities that would have produced general limitation income that is not subpart F income. In 1996

CFC also earns 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A), and 100u of foreign personal holding company income that is dividend income subject to a separate limitation described in section 904(d)(1)(E) for dividends from a noncontrolled section 902 corporation. *CFC*'s subpart F income for 1996, 300u, exceeds *CFC*'s current earnings and profits, 100u, by 200u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to *CFC*'s current earnings and profits of 100u, all of which is included in *A*'s gross income under section 951(a)(1)(A). The 200u of *CFC*'s 1996 subpart F income that is not included in *A*'s income in 1996 by reason of section 952(c)(1)(A) is subject to recapture under section 952(c)(2) and paragraph (f) of this section.

(ii) For purposes of determining the amount and type of income included in *A*'s gross income and the amount and type of income in *CFC*'s recapture account, the rules of paragraphs (e)(1) and (2) of this section apply. Under paragraph (e)(1)(i), the amount by which *CFC*'s subpart F income exceeds its earnings and profits for 1996, 200u, first reduces from 100u to 0 *CFC*'s subpart F income in the general limitation category, which has a current year deficit of (100u) in earnings and profits. Next, under paragraph (e)(1)(iii) of this section, the remaining 100u by which *CFC*'s 1996 subpart F income exceeds earnings and profits is applied proportionately to reduce *CFC*'s subpart F income in the separate categories for passive income (100u) and dividends from the noncontrolled section 902 corporation (100u). Thus, *A* includes 50u of passive limitation/foreign personal holding company income and 50u of dividends from the noncontrolled section 902 corporation/foreign personal holding company income in gross income in 1996. *CFC* has 100u in its general limitation/foreign base company sales income recapture account attributable to the 100u of foreign base company sales income that is not included in *A*'s income by reason of the earnings and profits limitation of section 952(c)(1)(A). *CFC* also has 50u in its passive limitation recapture account, all of which is attributable to foreign personal holding company income, and 50u in its recapture account for dividends from the noncontrolled section 902 corporation, all of which is attributable to foreign personal holding company income.

(iii) For purposes of computing post-1986 undistributed earnings, the rules of sections 902 and 960, including the rules of § 1.960-1(i), apply. Under § 1.960-1(i), the general limitation deficit of (100u) is allocated proportionately to reduce passive limitation earnings of 100u and noncontrolled section 902 dividend earnings of 100u. Thus, passive limitation earnings are reduced by 50u to 50u (100u passive limitation earnings/200u total earnings in positive separate categories \times (100u) general limitation deficit = 50u reduction), and the noncontrolled section 902 corporation earnings are reduced by 50u to 50u (100u noncontrolled section 902 corporation earnings/200u total earnings in positive separate categories \times (100u) general limitation deficit = 50u reduction). All of

CFC's post-1986 foreign income taxes with respect to passive limitation income and dividends from the noncontrolled section 902 corporation are deemed paid by *A* under section 960 with respect to the subpart F inclusions (50u inclusion/50u earnings in each separate category). After the inclusion and deemed-paid taxes are computed, at the close of 1996 *CFC* has a (100u) deficit in general limitation earnings (100u subpart F earnings + (200u) nonsubpart F loss), 50u of passive limitation earnings (100u of earnings attributable to foreign personal holding company income - 50u inclusion) with a corresponding passive limitation/foreign personal holding company income recapture account of 50u, and 50u of earnings subject to a separate limitation for dividends from the noncontrolled section 902 corporation (100u earnings - 50u inclusion) with a corresponding noncontrolled section 902 corporation/foreign personal holding company income recapture account of 50u.

Example 2. (i) The facts are the same as in *Example 1* with the addition of the following facts. In 1997, *CFC* earns 100u of foreign base company sales income that is general limitation income and 100u of foreign personal holding company income that is passive limitation income. In addition, *CFC* incurs (10u) of expenses that are allocable to its separate limitation for dividends from the noncontrolled section 902 corporation. Thus, *CFC*'s subpart F income for 1997, 200u, exceeds *CFC*'s current earnings and profits, 190u, by 10u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to *CFC*'s current earnings and profits of 190u, all of which is included in *A*'s gross income under section 951(a)(1)(A).

(ii) For purposes of determining the amount and type of income included in *A*'s gross income and the amount and type of income in *CFC*'s recapture accounts, the rules of paragraphs (e) (1) and (2) of this section apply. While *CFC*'s general limitation post-1986 undistributed earnings for 1997 are 0 ((100u) opening balance + 100u subpart F income), *CFC*'s general limitation subpart F income (100u) does not exceed its general limitation current earnings and profits (100u) for 1997. Accordingly, under paragraph (e)(1)(iii) of this section, the amount by which *CFC*'s subpart F income exceeds its earnings and profits for 1997, 10u, is applied proportionately to reduce *CFC*'s subpart F income in the separate categories for general limitation income, 100u, and passive income, 100u. Thus, *A* includes 95u of general limitation foreign base company sales income and 95u of passive limitation foreign personal holding company income in gross income in 1997. At the close of 1997 *CFC* has 105u in its general limitation/foreign base company sales income recapture account (100u from 1996 + 5u from 1997), 55u in its passive limitation/foreign personal holding company income recapture account (50u from 1996 + 5u from 1997), and 50u in its dividends from the noncontrolled section 902 corporation/foreign personal holding company income recapture account (all from 1996).

(iii) For purposes of computing post-1986 undistributed earnings in each separate

category, the rules of sections 902 and 960, including the rules of § 1.960-1(i), apply. Thus, post-1986 undistributed earnings (or an accumulated deficit) in each separate category are increased (or reduced) by current earnings and profits or current deficits in each separate category. The accumulated deficit in *CFC*'s general limitation earnings and profits (100u) is reduced to 0 by the addition of 100u of 1997 earnings and profits. *CFC*'s passive limitation earnings of 50u are increased by 100u to 150u, and *CFC*'s noncontrolled section 902 corporation earnings of 50u are decreased by (10u) to 40u. After the addition of current year earnings and profits and deficits to the separate categories there are no deficits remaining in any separate category. Thus, the allocation rules of § 1.960-1(i)(4) do not apply in 1997. Accordingly, in determining the post-1986 foreign income taxes deemed paid by *A*, post-1986 undistributed earnings in each separate category are unaffected by earnings in the other categories. Foreign taxes deemed paid under section 960 for 1997 would be determined as follows for each separate category: with respect to the inclusion of 95u of foreign base company sales income out of general limitation earnings, the section 960 fraction is 95u inclusion/0 total earnings; with respect to the inclusion of 95u of passive limitation income the section 960 fraction is 95u inclusion/150u passive earnings. Thus, no general limitation taxes would be associated with the inclusion of the general limitation earnings because there are no accumulated earnings in the general limitation category. After the deemed-paid taxes are computed, at the close of 1997 *CFC* has a (95u) deficit in general limitation earnings and profits ((100u) opening balance + 100u current earnings—95u inclusion), 55u of passive limitation earnings and profits (50u opening balance + 100u current foreign personal holding company income—95u inclusion), and 40u of earnings and profits subject to the separate limitation for dividends from the noncontrolled section 902 corporation (50u opening balance + (10u) expense).

Example 3. (i) *A*, a U.S. person, is the sole shareholder of *CFC*, a controlled foreign corporation whose functional currency is the *u*. At the beginning of 1996, *CFC* has post-1986 undistributed earnings of 275u, all of which are general limitation earnings described in section 904(d)(1)(I). *CFC* has no previously-taxed earnings and profits described in section 959 (c)(1) or (c)(2). In 1996, *CFC* has a (200u) loss in the shipping category described in section 904(d)(1)(D), 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A), and 125u of general limitation manufacturing earnings that are not subpart F income. *CFC*'s subpart F income for 1996, 100u, exceeds *CFC*'s current earnings and profits, 25u, by 75u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to *CFC*'s current earnings and profits of 25u, all of which is included in *A*'s gross income under section 951(a)(1)(A). The 75u of *CFC*'s 1996 subpart F income that is not included in *A*'s income in 1996 by reason of section 952(c)(1)(A) is subject to recapture under

section 952(c)(2) and paragraph (f) of this section.

(ii) For purposes of determining the amount and type of income included in A's gross income and the amount and type of income in CFC's recapture account, the rules of paragraphs (e) (1) and (2) of this section apply. Under paragraph (e)(1) of this section, the amount of CFC's subpart F income in excess of earnings and profits for 1996, 75u, reduces the 100u of passive limitation foreign personal holding company income. Thus, A includes 25u of passive limitation foreign personal holding company income in gross income, and CFC has 75u in its passive limitation/foreign personal holding company income recapture account.

(iii) For purposes of computing post-1986 undistributed earnings in each separate category the rules of sections 902 and 960, including the rules of § 1.960-1(i), apply. Under § 1.960-1(i), the shipping limitation deficit of (200u) is allocated proportionately to reduce general limitation earnings of 400u and passive limitation earnings of 100u. Thus, general limitation earnings are reduced by 160u to 240u (400u general limitation earnings/500u total earnings in positive separate categories × (200u) shipping deficit = 160u reduction), and passive limitation earnings are reduced by 40u to 60u (100u passive earnings/500u total earnings in positive separate categories × (200u) shipping deficit = 40u reduction). Five-twelfths of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the subpart F inclusion (25u inclusion/60u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1996 CFC has 400u of general limitation earnings (275u opening balance + 125u current earnings), 75u of passive limitation earnings (100u of foreign personal holding company income - 25u inclusion), and a (200u) deficit in shipping limitation earnings.

Example 4. (i) The facts are the same as in *Example 3* with the addition of the following facts. In 1997, CFC earns 50u of general limitation earnings that are not subpart F income and 75u of passive limitation income that is foreign personal holding company income. Thus, CFC has 125u of current earnings and profits. CFC distributes 200u to A. Under paragraph (f)(3)(ii) of this section, the recapture rules are applied first. Thus, the amount by which 1997 current earnings and profits exceed subpart F income, 50u, is recharacterized as passive limitation foreign personal holding company income. CFC's total subpart F income for 1997 is 125u of passive limitation foreign personal holding company income (75u current earnings plus 50u recapture account), and the passive limitation/foreign personal holding company income recapture account is reduced from 75u to 25u.

(ii) CFC has 150u of previously-taxed earnings and profits described in section 959(c)(2) (25u attributable to 1996 and 125u attributable to 1997), all of which is passive limitation earnings and profits. Under section 959(c), 150u of the 200u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining

50u is deemed to be made from earnings and profits described in section 959(c)(3). Under paragraph (f)(3)(i) of this section, the dividend distribution is deemed to be made first out of the passive limitation recapture account to the extent thereof (25u). Under paragraph (f)(2)(iii) of this section, the passive limitation recapture account is reduced from 25u to 0. The remaining distribution of 25u is treated as made out of CFC's general limitation earnings and profits.

(iii) For purposes of computing post-1986 undistributed earnings, the rules of section 902 and 960, including the rules of § 1.960-1(i), apply. Thus, the shipping limitation accumulated deficit of (200u) reduces general limitation earnings and profits of 450u and passive limitation earnings and profits of 150u on a proportionate basis. Thus, 100% of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the 1997 subpart F inclusion of 125u (100u inclusion (numerator limited to denominator)/100u passive earnings). No post-1986 foreign income taxes remain to be deemed paid under section 902 in connection with the 25u distribution from the passive limitation/foreign personal holding company income recapture account. One-twelfth of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the distribution of 25u general limitation earnings and profits described in section 959(c)(3) (25u inclusion/300u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1997 CFC has 425u of general limitation earnings and profits (400u opening balance + 50u current earnings - 25u distribution), 0 of passive limitation earnings (75u recapture account + 75u current foreign personal holding company income - 125u inclusion - 25u distribution), and a (200u) deficit in shipping limitation earnings.

Par. 3. In § 1.952-2, paragraph (c)(1) is revised to read as follows:

§ 1.952-2 Determination of gross income and taxable income of a foreign corporation.

* * * * *

(c) *Special rules for purposes of this section*—(1) *Nonapplication of certain provisions.* Except where otherwise distinctly expressed, the provisions of section 103 and subchapters F, G, H, L, M, N, S, and T of chapter 1 of the Internal Revenue Code shall not apply.

* * * * *

Par. 4. In § 1.954-2, the text of paragraph (b)(3) is added to read as follows:

§ 1.954-2 Foreign personal holding company income.

* * * * *

(b) * * *

(3) *Treatment of tax exempt interest.* Foreign personal holding company income includes all interest income,

including interest that is described in section 103 (see § 1.952-2(c)(1)).

* * * * *

Par. 5. In § 1.960-1, paragraph (i) is added to read as follows:

§ 1.960-1 Foreign tax credit with respect to taxes paid on earnings and profits of controlled foreign corporations.

* * * * *

(i) *Computation of deemed-paid taxes in post-1986 taxable years*—(1) *General rule.* If a domestic corporation is eligible to compute deemed-paid taxes under section 960(a)(1) with respect to an amount included in gross income under section 951(a), then, such domestic corporation shall be deemed to have paid a portion of such foreign corporation's post-1986 foreign income taxes determined under section 902 and the regulations under that section in the same manner as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).

(2) *Ordering rule for computing deemed-paid taxes under sections 902 and 960.* If a domestic corporation computes deemed-paid taxes under both section 902 and section 960 in the same taxable year, section 960 shall be applied first. After the deemed-paid taxes are computed under section 960 with respect to a deemed income inclusion, post-1986 undistributed earnings and post-1986 foreign income taxes in each separate category shall be reduced by the appropriate amounts before deemed-paid taxes are computed under section 902 with respect to a dividend distribution.

(3) *Computation of post-1986 undistributed earnings.* Post-1986 undistributed earnings (or an accumulated deficit in post-1986 undistributed earnings) are computed under section 902 and the regulations under that section.

(4) *Allocation of accumulated deficits.* For purposes of computing post-1986 undistributed earnings under sections 902 and 960, a post-1986 accumulated deficit in a separate category shall be allocated proportionately to reduce post-1986 undistributed earnings in the other separate categories. However, a deficit in any separate category shall not permanently reduce earnings in other separate categories, but after the deemed-paid taxes are computed the separate limitation deficit shall be carried forward in the same separate category in which it was incurred. In addition, because deemed-paid taxes may not exceed taxes paid or accrued by the controlled foreign corporation, in computing deemed-paid taxes with

respect to an inclusion out of a separate category that exceeds post-1986 undistributed earnings in that separate category, the numerator of the deemed-paid credit fraction (deemed inclusion from the separate category) may not exceed the denominator (post-1986 undistributed earnings in the separate category).

(5) *Examples.* The application of this paragraph (i) may be illustrated by the following examples. See § 1.952-1(f)(4) for additional illustrations of these rules.

Example 1. (i) A, a U.S. person, is the sole shareholder of CFC, a controlled foreign corporation formed on January 1, 1996, whose functional currency is the *u*. In 1996 CFC earns 100u of general limitation income described in section 904(d)(1)(I) that is not subpart F income and 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A). In 1996 CFC also incurs a (50u) loss in the shipping category described in section 904(d)(1)(D). CFC's subpart F income for 1996, 100u, does not exceed CFC's current earnings and profits of 150u. Accordingly, all 100u of CFC's subpart F income is included in A's gross income under section 951(a)(1)(A). Under section 904(d)(3)(B) of the Code and paragraph (i)(1) of this section, A includes 100u of passive limitation income in gross income for 1996.

(ii) For purposes of computing post-1986 undistributed earnings under sections 902, 904(d) and 960 with respect to the subpart F inclusion, the shipping limitation deficit of (50u) is allocated proportionately to reduce general limitation earnings of 100u and passive limitation earnings of 100u. Thus, general limitation earnings are reduced by 25u to 75u (100u general limitation earnings/200u total earnings in positive separate categories \times (50u) shipping deficit = 25u reduction), and passive limitation earnings are reduced by 25u to 75u (100u passive earnings/200u total earnings in positive separate categories \times (50u) shipping deficit = 25u reduction). All of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the 100u subpart F inclusion of passive income (75u inclusion (numerator limited to denominator under paragraph (i)(4) of this section)/75u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1996 CFC has 100u of general limitation earnings, 0 of passive limitation earnings (100u of foreign personal holding company income—100u inclusion), and a (50u) deficit in shipping limitation earnings.

Example 2. (i) The facts are the same as in Example 1 with the addition of the following facts. In 1997, CFC distributes 150u to A. CFC has 100u of previously-taxed earnings and profits described in section 959(c)(2) attributable to 1996, all of which is passive limitation earnings and profits. Under section 959(c), 100u of the 150u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining 50u is deemed to be made from earnings and

profits described in section 959(c)(3). The entire dividend distribution of 50u is treated as made out of CFC's general limitation earnings and profits. See section 904(d)(3)(D).

(ii) For purposes of computing post-1986 undistributed earnings under section 902 with respect to the 1997 dividend of 50u, the shipping limitation accumulated deficit of (50u) reduces general limitation earnings and profits of 100u to 50u. Thus, 100% of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the 1997 dividend of 50u (50u dividend/50u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1997 CFC has 50u of general limitation earnings (100u opening balance - 50u distribution), 0 of passive limitation earnings, and a (50u) deficit in shipping limitation earnings.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

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DEPARTMENT OF LABOR

Office of the Secretary

Wage and Hour Division

29 CFR Parts 4 and 5

41 CFR Parts 50-201 and 50-206

RIN 1215-AA96

Amendments to Federal Contract Labor Laws by the Federal Acquisition Streamlining Act of 1994

AGENCY: Wage and Hour Division, Employment Standards Administration, Labor.

ACTION: Notice of proposed rulemaking, request for comments.

SUMMARY: The Federal Acquisition Streamlining Act of 1994 amends the Contract Work Hours and Safety Standards Act (CWHSSA) and the Walsh-Healey Public Contracts Act (PCA). This document proposes to conform applicable regulations to the statutory amendments that raise the coverage threshold of CWHSSA and, among other things, eliminate the eligibility requirements of the PCA. **DATES:** Comments are due on or before October 10, 1995.

ADDRESSES: Submit written comments to Maria Echaveste, Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3502 200 Constitution Avenue NW., Washington, DC 20210. Commenters who wish to receive notification of receipt of comments are requested to include a self-addressed, stamped postcard, or to

submit them by certified mail, return receipt requested. As a convenience to commenters, comments may be transmitted by facsimile ("FAX") machine to (202) 219-5122 (this is not a toll-free number). If transmitted by facsimile and a hard copy is also submitted by mail, please indicate on the hard copy that it is a duplicate copy of the facsimile transmission.

FOR FURTHER INFORMATION CONTACT: Richard M. Brennan, Acting Director, Division of Policy and Analysis, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3506, 200 Constitution Avenue NW., Washington, DC 20210, (202) 219-8412. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:

I. Paperwork Reduction Act

This rule contains no reporting or recordkeeping requirements subject to the Paperwork Reduction Act of 1980 (Pub. L. 96-511).

II. Background

The Federal Acquisition Streamlining Act of 1994 (FASA) (Pub. L. 103-355, 108 Stat. 3243) was enacted into law on October 13, 1994. Section 4104(c) of this Act amends sections 103 and 107 of the Contract Work Hours and Safety Standards Act (CWHSSA), 40 U.S.C. 327 *et seq.*, to establish a threshold of \$100,000 or more for contracts subject to CWHSSA's overtime provisions. Prior to this amendment, Federal and Federally assisted construction contracts of \$2,000 or less, and purchases and contracts other than construction contracts of \$2,500 or less, were exempt from CWHSSA's weekly overtime and related provisions pursuant to the variation in §§ 5.15(b) (1) and (2) of 29 CFR part 5. The new statutory threshold of \$100,000 requires conforming revisions to §§ 5.5(b) and 5.15(b) (1) and (2) of 29 CFR part 5 and § 4.181(b) of 29 CFR part 4.

Contracting agencies and contractors should be aware that contractors awarded contracts in amounts less than \$100,000 may continue to have obligations to pay certain of their employees weekly overtime, at one and one-half the regular rate for hours worked in excess of forty (40) per week, pursuant to section 7 of the Fair Labor Standards Act, 29 U.S.C. 207.

With respect to amendments affecting the Walsh-Healey Public Contracts Act (PCA), sections 3023 and 7201 of FASA (1) repeal 10 U.S.C. sec. 7299 to eliminate the applicability of the PCA to contracts for the construction, alternation, furnishing, or equipping of naval vessels; (2) repeal section 1(a) of