

respect to pre-1987 accumulated profits must be translated into United States dollars under the rules in effect prior to the effective date of the Tax Reform Act of 1986. See *The Bon Ami Company v. Commissioner*, 39 B.T.A. 825 (1939).

Paragraph (b)(1) provides rules for computing the foreign income taxes deemed paid by a domestic shareholder, first-tier corporation or second-tier corporation for any taxable year in which a domestic shareholder receives a dividend from a first-tier corporation paid out of post-1986 undistributed earnings, or an upper-tier corporation receives a dividend from a lower-tier corporation paid out of post-1986 undistributed earnings.

Paragraph (b)(2) provides rules for allocating dividends to post-1986 undistributed earnings and pre-1987 accumulated profits when a foreign corporation pays a dividend out of both post-1986 undistributed earnings and pre-1987 accumulated profits and out of more than one pre-1987 taxable year. Paragraph (b)(3) provides that the amount of foreign taxes deemed paid on a dividend out of pre-1987 accumulated profits must be computed under section 902 as in effect prior to the effective date of the Tax Reform Act of 1986.

Paragraph (b)(4) provides that if a foreign corporation makes a distribution out of current earnings and profits that is treated as a dividend under section 316(a)(2) in a taxable year in which the corporation has a deficit in post-1986 undistributed earnings and the sum of current plus accumulated earnings and profits is zero or less than zero, then no foreign income taxes shall be deemed paid with respect to the dividend. See S. Rep. No. 313, 99th Cong., 2d Sess. 321 (1986). The dividend reduces post-1986 undistributed earnings and accumulated earnings and profits.

Paragraph (c) provides special rules applicable in computing foreign taxes deemed paid by a domestic shareholder or upper-tier corporation. Paragraph (c)(1) provides that foreign taxes deemed paid must be computed separately for dividends received from each foreign corporation. Further, if a domestic shareholder receives a dividend from a first-tier corporation and in the same taxable year the first-tier corporation receives a dividend from one or more lower-tier corporations, then foreign taxes deemed paid are computed by starting at the lowest tier and working upward.

Paragraph (c)(2) requires a domestic shareholder to include in gross income as a dividend under section 78 all foreign taxes deemed paid for the taxable year. Foreign corporations are not required to include foreign taxes

deemed paid in gross income under section 78.

Paragraph (c)(9) incorporates the rules of section 905(c) to determine the effect of a section 482 adjustment on post-1986 undistributed earnings and post-1986 foreign income taxes. In general, section 905(c) and the regulations under that section require a reduction in the pool of creditable foreign income taxes when a taxpayer fails to exhaust its administrative remedies to obtain a refund of foreign income taxes paid following a section 482 adjustment. See also Rev. Rul. 92-74, 1992-2 C.B. 156.

Paragraph (d) provides rules relating to the computation of foreign taxes deemed paid with respect to dividends from controlled foreign corporations. Generally, dividend distributions are treated as made pro rata out of a controlled foreign corporation's earnings in each section 904(d) separate category. Section 1.904-5(d). Paragraph (d)(3)(i) provides that dividends distributed out of earnings accumulated before a foreign corporation became a controlled foreign corporation are treated as dividends from a noncontrolled section 902 corporation, whether the earnings are post-1986 undistributed earnings or pre-1987 accumulated profits.

Pursuant to a grant of regulatory authority in section 904(d)(2)(E)(i), and consistent with proposed amendments to § 1.904-4(g)(3), paragraph (d)(3)(ii) generally limits the application of the Technical and Miscellaneous Revenue Act of 1988 amendment of section 904(d)(2)(E)(i) (restricting look-through treatment on dividends out of pre-acquisition earnings of a controlled foreign corporation) to U.S. shareholders that acquire more than 90% voting stock ownership in an existing controlled foreign corporation (including both U.S. shareholders who previously owned no voting stock in the controlled foreign corporation and U.S. shareholders that previously owned less than 10% of the controlled foreign corporation's voting stock). A U.S. shareholder that acquires more than 90% ownership of a controlled foreign corporation's voting stock must begin a new set of post-1986 undistributed earnings and post-1986 foreign income taxes pools on the first day of the first taxable year in which it owns more than 90% of the voting stock. Earnings attributable to the pre-acquisition period are treated as post-1986 undistributed earnings or pre-1987 accumulated profits of a noncontrolled section 902 corporation. Distributions will be deemed to come first out of the post-acquisition earnings pools to the extent

thereof, and then out of pre-acquisition earnings.

A U.S. shareholder that acquires stock resulting in ownership of 90% or less of an existing controlled foreign corporation's voting stock is entitled to look-through treatment on dividends paid out of pre-acquisition earnings of the controlled foreign corporation. The shareholder need not start new pools of earnings and taxes as a result of its acquisition of voting stock of the controlled foreign corporation.

Paragraph (e) describes the information a domestic shareholder must furnish with respect to foreign income taxes for which it claims a deemed paid credit.

Paragraph (f) provides examples illustrating the rules of § 1.902-1, and paragraph (g) provides that § 1.902-1 applies to distributions in and after a foreign corporation's first taxable year beginning on or after January 1, 1987.

Section 1.902-2

Section 1.902-2 provides rules for computing foreign taxes deemed paid when there are deficits in post-1986 undistributed earnings or pre-1987 accumulated profits (determined under section 902) of a foreign corporation. Paragraph (a)(1) provides that if there is a deficit in post-1986 undistributed earnings of a first-, second-, or third-tier corporation and the corporation makes a distribution to shareholders, then the deficit shall be carried back to the most recent pre-effective date taxable year of the first-, second-, or third-tier corporation with positive accumulated profits determined under section 902. The amount carried back will be removed from post-1986 undistributed earnings, but any foreign income taxes paid with respect to those earnings will not be carried back to a taxable year beginning before January 1, 1987 (or a later year if the special effective date of § 1.902-1(a)(13) applies) and will not be removed from post-1986 foreign income taxes.

Paragraph (b)(1) provides that if there is a deficit in accumulated profits determined under section 902 of a first-, second-, or third-tier corporation as of the end of its last pre-effective date taxable year, that deficit must be carried forward to the first taxable year of the foreign corporation beginning after December 31, 1986, or later if the special effective date of § 1.902-1(a)(13) applies. The deficit carried forward is included in and reduces post-1986 undistributed earnings. Foreign income taxes paid with respect to pre-effective date years are not carried forward.

Paragraph (b)(2) makes clear that if a corporation has a deficit in section 902