Federal Register
Vol. 57, No. 94
Thursday, May 14, 1992

Presidential Documents

Title 3—

The President

Executive Order 12805 of May 11, 1992

Integrity and Efficiency in Federal Programs

By the authority vested in me as President by the Constitution and the laws of the United States of America, and in order to coordinate and enhance governmental efforts to promote integrity and efficiency and to detect and prevent fraud, waste, and abuse in Federal programs, the establishment of two Councils of Federal Inspectors General and appropriate Federal officials is hereby ordered as follows:

Section 1. *Establishment of the President's Council on Integrity and Efficiency.*

(a) There is established as an interagency committee the President's Council on Integrity and Efficiency (PCIE).

(b) The PCIE shall be composed of the following members:

(1) The Deputy Director for Management of the Office of Management and Budget, who shall be Chairperson of the Council;

(2) All civilian Presidentially appointed Inspectors General whose offices were established in the Inspector General Act of 1978 and subsequent amendments;

(3) The Vice Chairperson of the Executive Council on Integrity and Efficiency;

(4) The Controller of the Office of Federal Financial Management;

(5) The Associate Deputy Director for Investigations of the Federal Bureau of Investigation;

(6) The Director of the Office of Government Ethics;

(7) The Special Counsel of the Office of Special Counsel; and

(8) The Deputy Director of the Office of Personnel Management.

(c) The Chairperson may, from time to time, invite other officials to participate in meetings of the PCIE.

(d) The Chairperson shall, to the extent possible, convene meetings of the PCIE monthly.

Sec. 2. *Establishment of the Executive Council on Integrity and Efficiency.*

(a) There is established as an inter-entity committee the Executive Council on Integrity and Efficiency (ECIE).

(b) The ECIE shall be composed of the following members:

(1) The Deputy Director for Management of the Office of Management and Budget, who shall be Chairperson of the Council;

(2) All civilian statutory Inspectors General not represented on the PCIE;

(3) The Vice Chairperson of the PCIE;

(4) The Controller of the Office of Federal Financial Management;

(5) The Associate Deputy Director for Investigations of the Federal Bureau of Investigation, or his or her designee;

(6) The Director of the Office of Government Ethics, or his or her designee;

(7) The Special Counsel of the Office of Special Counsel, or his or her designee; and

(8) The Deputy Director of the Office of Personnel Management, or his or her designee.

(c) If any individual simultaneously serves as a Presidentially appointed Inspector General and as Inspector General of an entity represented on the ECIE, that individual may send a designee to ECIE meetings.

(d) The Chairperson may, from time to time, invite other officials to participate in meetings of the ECIE.

(e) The Chairperson or, in his or her absence, the Controller of the Office of Federal Financial Management shall, to the extent possible, convene meetings of the ECIE monthly.

Sec. 3. *Functions of the PCIE and the ECIE.*

(a) The Councils shall continually identify, review, and discuss areas of weakness and vulnerability in Federal programs and operations to fraud, waste, and abuse, and shall develop plans for coordinated, Governmentwide activities that address these problems and promote economy and efficiency in Federal programs and operations. These activities will include interagency and inter-entity audit and investigation programs and projects to deal efficiently and effectively with those problems concerning fraud and waste that exceed the capability or jurisdiction of an individual agency or entity. The Councils shall recognize the preeminent role of the Department of Justice in law enforcement and litigation.

(b) The Councils shall develop policies that will aid in the establishment of a corps of well-trained and highly skilled Office of Inspector General staff members.

(c) The individual members of the Councils should, to the extent permitted under law, adhere to professional standards developed by the Councils and participate in the plans, programs, and projects of the Councils.

(d) The creation and operation of the Councils shall neither interfere with existing authority and responsibilities in the relevant agencies and entities nor augment or diminish the statutory authority or responsibilities of individual members of either Council.

Sec. 4. *Responsibilities of the Chairperson of the PCIE and the ECIE.*

(a) The Chairperson may appoint a Vice Chairperson from the PCIE and the ECIE to assist in carrying out the functions of each Council.

(b) The Chairperson shall, in consultation with the members of each Council, establish the agenda for PCIE and ECIE activities.

(c) The Chairperson shall, on behalf of the Councils, report to the President on the activities of the Councils. The Chairperson shall, as appropriate, advise the Councils with respect to the President's consideration of the Councils' activities.

(d) The Chairperson shall provide agency and entity heads with summary reports of the activities of the Councils.

(e) The Chairperson shall establish, in consultation with members of the Councils, such committees of the PCIE and the ECIE as deemed necessary and appropriate for the efficient conduct of PCIE and ECIE functions. The Chairperson may invite members of the ECIE to serve on each PCIE Committee. Similarly, the Chairperson may invite members of the PCIE to serve on each ECIE Committee.

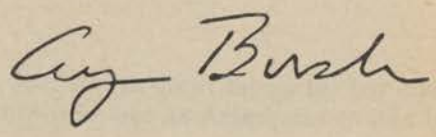
(f) The Chairperson shall convene joint meetings of the PCIE and the ECIE at least annually.

Sec. 5. *Administrative Provisions.*

(a) The Director of the Office of Management and Budget shall provide the PCIE and the ECIE with such administrative support as may be necessary for the performance of the functions of the Councils.

(b) The heads of agencies and entities represented on the PCIE and the ECIE shall provide their representatives with such administrative support as may be necessary, in accordance with law, to enable the representatives to carry out their responsibilities.

Sec. 6. *Revocation.* Executive Order No. 12625 of January 27, 1988, entitled "Integrity and Efficiency in Federal Programs," is revoked.



THE WHITE HOUSE,
May 11, 1992.

[FR Doc. 92-11528
Filed 5-12-92; 3:10 pm]
Billing code 3195-01-M

Presidential Documents

Proclamation 6435 of May 12, 1992

Small Business Week, 1992

By the President of the United States of America

A Proclamation

Small business men and women accomplish great things for our communities and country, and each year it is our privilege as Americans to join in saluting these present-day pioneers.

Through their willingness to take risks and to do the hard work that is necessary to improve existing products and services or to design, develop, and market new ones, small business people are leading America's economic productivity and innovation. Indeed, small business is the lifeblood of our Nation's free enterprise system. This resilient sector generates two of every three jobs in the United States and has been cited by forecasters as the driving force behind the more than 850,000 new jobs that were created in 1991. In addition, small businesses employ more than half of the American work force—often providing that crucial first job to young people and other disadvantaged workers—while generating some 44 percent of all sales and 39 percent of our GNP. Today, as we look toward the vast frontier that is the 21st century, we know that small business men and women will continue to play a vital role in moving the United States forward to even greater heights of prosperity and progress.

In the future, the success of American small business will have increasing impact around the globe. Indeed, as they strive to overcome impoverishment and stagnation imposed by years of totalitarian rule, more and more of the world's emerging democracies are looking to the United States as a model of private initiative and market principles in action. Hence, it is important that we continue to promote a climate in which small businesses can thrive. This means alleviating the high cost of capital and the heavy burden of excessive government regulation, which stifle investment and creativity. Encouraging the success of small business will also require a continuing commitment to excellence in education, which is vital to producing workers who have the knowledge and skills that are necessary to excel in the increasingly competitive global marketplace. Today, it is gratifying to note that many small businesses have joined in support of AMERICA 2000, our comprehensive strategy to achieve our National Education Goals.

From their daily contributions toward our local and national economies to their generous participation in voluntary community service programs and other worthwhile endeavors, small business men and women are helping to build a better America for all of us. Thus, these enterprising individuals richly deserve our support and thanks.

NOW, THEREFORE, I, GEORGE BUSH, President of the United States of America, by virtue of the authority vested in me by the Constitution and laws of the United States, do hereby proclaim the week of May 10 through May 16 as Small Business Week. I urge all Americans to join me in saluting our Nation's small business men and women by observing this week with appropriate ceremonies and activities.

IN WITNESS WHEREOF, I have hereunto set my hand this twelfth day of May, in the year of our Lord nineteen hundred and ninety-two, and of the Independence of the United States of America the two hundred and sixteenth.

George Bush

[Fr Doc. 92-11529
Filed 5-12-92; 3:18 pm]
Billing code 3195-01-M

Rules and Regulations

Federal Register
Vol. 57, No. 94
Thursday, May 14, 1992

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.
The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 5, 7, 12, 15, 20, 140 and 149

Miscellaneous Rule Deletions, Amendments or Clarifications

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or "Commission") hereby is deleting miscellaneous rules which are redundant, which have been superseded or are now otherwise unnecessary. In addition, the Commission is amending other rules by making technical or conforming changes.

EFFECTIVE DATE: June 15, 1992.

FOR FURTHER INFORMATION CONTACT: Paul M. Architzel, Chief Counsel, Division of Economic Analysis, Commodity Futures Trading Commission, 2033 K St. NW., Washington, DC 20581, (202) 254–6990.

SUPPLEMENTARY INFORMATION: The Commission recently has undertaken a thorough reexamination of all of its rules. As part of this reexamination, the Commission has identified those rules which are redundant, which have been superseded or are now otherwise unnecessary: In addition, various of these rules are being amended to make technical or conforming changes.

I. Rules Being Deleted

The following Commission rules are being deleted.

A. 17 CFR 5.3

Commission Rule 5.3 requires exchanges with "low-volume" futures contracts to submit a report to the Commission that was intended to provide an additional means of monitoring potential trade practice problems, such as noncompetitive and prearranged trades, as well as the extent of commercial participation in such markets (47 FR 29515 (July 7, 1982)). Under this rule, a low-volume contract is one with fewer than 1,000 contracts traded in at least four of any six consecutive calendar months. The reports required under the rule are designed to provide information on the nature of the trading activity in a low-volume contract and to assure that the exchange has an adequate program for surveillance of trade practices in such a contract. The reports were also intended to provide for the monitoring of commercial participation in such markets as a means of assessing whether trade practice abuses may be adversely affecting the accuracy of prices. During the past four years, the Commission has received an average of 15 low-volume reports per year, filed by a total of seven exchanges.

Although low-volume contracts may require specialized surveillance procedures,[1] the Commission is proposing to delete Rule 5.3 because it believes that the report required by Rule 5.3 is not needed to monitor such problems. The regular surveillance programs of the exchanges and the CFTC provide sufficient information concerning daily activity in such contracts, and the Commission relies on the exchanges in the first instance to use its surveillance programs to monitor potential trade practice problems. Further, the periodic reviews of the exchange rule enforcement programs by the Commission address the adequacy of exchange trade practice investigations for such markets as well as all other markets.

B. 17 CFR 7.100, 7.101 and 7.200

Commission Rules 7.100, 7.101 and 7.200 alter rules of the Chicago Mercantile Exchange's 13-week U.S. Treasury bill futures contract and one-year U.S. Treasury bill futures contract and the Chicago Board of Trade's long-term U.S. Treasury bond futures contract, respectively. These rules were adopted by the Commission in 1980, pursuant to its authority under section 8a(7) of the Act, 45 FR 51520 (August 1, 1980), and require the exchanges to submit changes in trading hours and the listing of delivery months of the affected contracts for prior Commission approval under section 5a(12) of the Act.

Following enactment of the Futures Trading Act of 1982, which included amendments to section 5a(12) of the Act, the Commission amended Rule 1.41(a) to clarify that all contract trading months and hours must be approved by the Commission before taking effect. 48 FR 4256 (January 28, 1983); 48 FR 49003 (October 24, 1983). Subsequently, the Commission provided for expedited approval of routine, non-controversial changes in delivery months and trading hours. See, 17 CFR 1.41 (k) and (*l*) In light of these provisions, Regulations 7.100, 7.101 and 7.200 have become redundant and may be removed.

C. 17 CFR Part 12

Several Commission rules relating to its procedures regarding reparations proceedings are being amended to delete references to proceedings officer. Originally, the role of proceedings officer was created to expedite certain phases of reparation proceedings, such as discovery, by using the proceeding officer to assist the administrative law judges. In practice, the use of the proceeding officer did not result in a time savings and its use has been discontinued. Accordingly, the Commission is deleting rules or references relating to "proceedings officer" from its rules.

D. 17 CFR 15.04

Section 15.04 of the regulations requires that where more than one type of futures contract on the same commodity is traded on the same exchange for the same expiration month, a trader's position in each type of contract be combined for reporting purposes. Generally, parts 17 and 18 of the regulations require reports from members of contracts markets, FCMs or foreign brokers ("firms") and traders, respectively, when a trader holds a "reportable position," *i.e.*, any open position held or controlled by a trader at the close of business in any one future of a commodity traded on any one contract market that is equal to or in excess of the quantities fixed by the

[1] See, *e.g.*, *In re Buckwalter*, 2 Comm. Fut. L. Rep. (CCH) ¶24,995 (CFTC January 25, 1991).

Commission in § 15.03 of the regulations.[2]

It has long been the Commission's practice to set reporting levels separately for each contract that is traded on the same exchange, not in the consolidated manner permitted by § 15.04. Generally when more than one contract in a commodity is traded on the same exchange, terms and conditions of such contracts differ in some significant manner. For market surveillance, the Commission has required the filing of large trader positions separately for each type of contract. If there are concerns about traders holding positions in similar contracts, the Commission may adjust reporting levels in these contracts to obtain more complete information. In view of the fact that this regulation has not been used and is obsolete, the Commission is removing current Rule 15.04 from its regulations.

E. 17 CFR 20.00

Commission Rule 20.00 requires that members of contract markets report to the Commission any transactions which are not reported to the clearing organization of an exchange or recorded on the books of a member of such organization. Formerly, certain transactions among members of a contract market, commonly called "pass outs", could be excluded from the trade clearing process or not reported to a clearing member. In order to monitor the extent and nature of passouts, the Commission required reports from members executing such transactions. Currently, however, all transactions executed on the floor of an exchange are recorded on the books of a clearing member and are subject to clearing according to the rules of the appropriate clearing organization. Because the Commission receives reports from all exchanges concerning transactions on the books of their associated clearing members,[3] there is no longer a need for the reporting requirement contained in Rule 20.00. Accordingly, the Commission is removing and reserving this section of its rules.

F. 17 CFR 140.61 and 140.81

Commission Rule 140.61 delegates authority to the Chief Administrative Law Judge, among other things, to appoint a presiding officer to hear summary proceedings conducted under (now-eliminated) subpart G of part 12 of the Commission regulations. However, the 1982 amendments to the Commodity Exchange Act and subsequent rule revisions eliminated the need for this delegation. Accordingly, the rule is now being removed.

Commission Rule 140.81 delegates authority to the Director of the Complaints Section to perform certain ministerial functions in the administration of the CFTC reparations program. The 1982 amendments to the Commodity Exchange Act and subsequent revisions to the Commission's rules have eliminated the need for this delegation.

G. 17 CFR 149.110

Commission Rule 149.110 provides that by August 24, 1987, the CFTC must perform a self-evaluation of its practices and policies under its regulations concerning nondiscrimination on the basis of handicap and maintain records of its evaluation for three years. The agency's self-evaluation took place in 1987 and five years have since passed. Regulation 149.110 is outdated and is therefore being removed.

II. Rules Being Revised

The following Commission rules are being revised in order to make certain technical corrections, to streamline Commission procedures and to eliminate certain unnecessary filing requirements.

A. 17 CFR 1.17

Commission Rule 1.17(h)(3)(vi) sets forth the filing requirements with respect to proposed subordination agreements [4] for FCMs and IBs, and applicants for registration in either category. The rule has required such applicants to file signed copies of proposed subordination agreements with NFA, with a signed copy to be filed with the appropriate Commission regional office. Registrants have been required to file signed copies of proposed subordination agreements with the Commission at the Office of the Chief Accountant, Division of Trading and Markets, in Washington, DC and with their designated self-regulatory organization (DSRO), if any. NFA is required to review proposed subordination agreements for applicants. The DSRO must review proposed subordination agreements for registrants, except in those few instances where a registrant is not a member of any DSRO, in which case the Commission must review such agreements.[5]

The Commission has determined to amend Rule 1.17(h)(3)(vi) to eliminate the need to file subordinated agreements with the Commission, except for those rare cases where a registrant is not a member of a DSRO. Currently, the vast majority of subordination agreements are approved by DSROs, subject to Commission oversight of such approval processes.

When Rule 1.17(h)(3)(iv) was originally proposed, Commission approval would have been required for all subordination agreements. 43 FR 15072, 15093–94 (April 10, 1978). As promulgated, the rule required subordination agreements to be reviewed by Commission staff or, if the firm was a member of a DSRO, by the staff of the firm's DSRO. 43 FR 39956, 39965–66, 39980 (September 8, 1978). We note that there was no registered futures association at the time, so many FCMs had no DSRO. Originally, the Commission believed it necessary to have greater involvement in the subordination agreement approval process because subordinated debt could be the major portion of a firm's capital. (Only 30 percent of required capital must be equity capital; also, subordinated debt that is subject to certain higher standards in addition to the basic minimum requirements for all subordinated debt can qualify as equity capital.) The use of such debt to meet capital requirements was a fairly new phenomenon at that time. Many SROs did not have standard form agreements concerning subordinated debt, such as were later developed. Given the greater experience and familiarity of the industry and DSROs with subordinated debt today, the Commission believes that it generally does not need to receive copies of each subordination agreement.

[2] Firms which carry accounts for traders who hold "reportable positions" are required to identify such accounts on a Form 102 and report on the series '01 forms any reportable positions in the account, the delivery notices issued or stopped by the account and any exchanges of futures for physicals. Traders who own or control reportable positions are required to file annually a CFTC Form 40 giving certain background information concerning their trading in commodity futures and on call by the Commission, must submit a Form 103 showing positions and transactions in the contract market specified in the call.

[3] See, for example, § 16.01 of the Commission's regulations 17 CFR 16.01 (1991).

[4] Subordination agreements govern the rights of lenders and borrowers with respect to subordinated debt. Lenders essentially agree to subordinate their rights to repayment to all present and future creditors of the borrower FCM or IB, including customers. The borrower FCM or IB is then able to exclude the repayment obligation from its liabilities when computing net capital, thus enhancing its net capital position by the amount borrowed.

[5] About a dozen of the approximately 300 registered FCMs are not members of any DSRO. Those dozen firms cannot deal with customers, since Commission Rule 170.15 requires any FCM that deals with customers to be an NFA member. A few registered IBs also fall into the category of firms that are not members of a DSRO.

B. 17 CFR 1.41(e)

Regulation 1.41(e) currently requires each contract market to furnish the Commission with written notification of any changes in its membership. It has been the Commission's experience with this requirement that the Commission has no routine need for such information. The Commission has come to believe that obtaining membership information on an as-needed basis would be sufficient to meet its regulatory needs. Therefore, the Commission is amending Regulation 1.41(e) by eliminating the requirement that membership changes be reported on a routine basis and replacing it with the requirement that each contract market provide a current membership list to the Commission upon request.

C. 17 CFR 1.43

Commission Rule 1.43 requires each contract market to file with the Commission a list of warehouses, depositories or similar entities ("facilities") in which or out of which commodities are deliverable in satisfaction of futures or options on physical contracts. The information required to be filed includes the name, location, and storage capacity of each facility and the name and business address of the facility's operator. This information is used principally for Market Surveillance purposes only on an as-needed basis. When needed, the Commission can obtain this information expeditiously from each exchange since the information is maintained as part of the exchanges normal business practices. In view of this, there is no need for a routine filing requirement in the Commission's regulations. Accordingly, the Commission is amending rule 1.43 to require that the exchanges file the information on call only.

D. 17 CFR 140.72, 140.73, 140.77 and 140.96

Commission Rule 140.96 delegates authority to the staff to publish rules of contract markets. It is being revised, herein, to further permit the staff to publish rules of self-regulatory organizations. This revision will further streamline the Commission review of rule changes by such self-regulatory organizations. Additionally, Commission Rules 140.72(a), 140.73 (a) and (b), and 140.77 are amended to reference the Division of Economic Analysis instead of the former name, the Division of Economics and Education.

E. 17 CFR 5.2

Commission Rule 5.2 provides that an exchange may recommence trading in a dormant futures or option contract only following CFTC approval (47 FR 29515 (July 7, 1982)). A dormant contract is defined as one in which no trading has occurred for a period of six complete calendar months; however, a contract is exempted from being considered as dormant under Rule 5.2 until the end of three years (36 months) after (1) the contract's designation, (2) a determination by the Commission at its discretion to permit this exemption after a review of the contract, or (3) Commission approval of a previous Rule 5.2 submission by the contract market. Rule 5.2 was adopted to ensure that any dormant contract that is reactivated continues to comply with the requirements of the Commodity Exchange Act.

Commission approval under Rule 5.2 is required prior to the recommencement of trading in a dormant contract to assure that the terms and conditions do not have deficiencies that could increase the likelihood of cash, futures, or option market disruptions and undermine the usefulness and efficiency of the market if trading were resumed. The most likely cause of such potential deficiencies would be changes in cash market practices over a period of years so that the terms and conditions of the dormant contract became obsolete. Therefore, a review of the contract terms and conditions of a dormant contract prior to the recommencement of trading is needed to assure that they continue to reflect current practices in the underlying cash market and provide for adequate deliverable supplies or cash settlement procedures.

An exchange wishing to list trading months for a dormant contract must make a submission under Rule 5.2 that includes an economic justification, including a review of cash market conditions. The submission also must include, if applicable, an explanation of how any new contract terms and conditions would reflect changes in cash market conditions.

The Commission has decided to extend the period of the exemptions from Rule 5.2 described above to five years (60 months) from the existing three years (36 months). The terms and conditions of most contracts do not need significant revisions due to changes in the cash market after three years and up to five years after designation or a previous approval to recommence trading under Rule 5.2. A review of the 18 submissions under Rule 5.2 since its adoption in 1982 indicates that 8 submissions involved contracts that had been dormant for 3 to 5 years. Four of those contracts required no rule changes. The rule changes for the other four contracts in this category apparently were not necessitated by changes in cash market conditions. Therefore, it appears that an extension of the exemption period to five years in most cases would not result in the resumption of trading in contracts that have obsolete contract terms. The review of contracts under Rule 5.2 after five years of dormancy should provide sufficient assurance that the objectives of this regulation will be met.

III. Related Matters

A. Administrative Procedure Act

The Commission has determined that the Administrative Procedure Act, 5 U.S.C. 553, does not require notice of proposed rulemaking and an opportunity for public participation in connection with the adoption of these amendments. In this regard, the Commission notes that such notice and opportunity for comment is unnecessary because these rule amendments are related solely to agency organization, procedure and practice, make technical corrections, or delete rules which have become surplusage or are obsolete on their face.

Although these rule amendments are being promulgated as final rules, the Commission nevertheless will consider comments from interested persons concerning these rule amendments within 30 days of publication of these rules in the **Federal Register**. Comments on these rule amendments should be mailed to the Commodity Futures Trading Commission, 2033 K St., NW., Washington, DC 20581, attention: Office of the Secretariat, and should make reference to "Miscellaneous Rules."

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C 601 *et seq.*, requires that agencies, in proposing rules, consider the impact of these rules on small entities. These rules relieve a regulatory burden, delete rules which are redundant, have been superseded or are otherwise unnecessary, or make technical and conforming changes. Accordingly, these amendments have no significant impact on a substantial number of small entities. For the above reasons, and pursuant to section 3(a) of the RFA, 5 U.S.C. 605(b), the Chairman, on behalf of the Commission, hereby certifies that these regulations will not have a significant economic impact on a substantial number of small entities.

C. Paperwork Reduction Act

The Paperwork Reduction Act of 1980, (Act) 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the Paperwork Reduction Act (PRA). In compliance with the Act the Commission has submitted these amended rules and their associated information collection requirements to the Office of Management and Budget.

Those rules associated with an information collection as defined by the PRA and the OMB number assigned to these information collections are as follows: [6]

[6] The following rules are not associated with an information collection: 17 CFR part 20; 17 CFR 7.100, 7.101, 7.200, 140.61, 140.81, 140.72, 140.73, 140.77, 140.96, and 149.11.

OMB No.	Information collection title	Rule
3038-0024	Regulations and Forms Pertaining to the Financial Integrity of the Market Place	17 CFR 1.17
3038-0022	Regulations Pertaining to the Responsibilities of Contract markets and their Members.	17 CFR 1.41
3038-0018	Information Concerning Warehouses	17 CFR 1.43
3038-0016	Compliance with Requirements for Designation as a Contract Market	17 CFR 5.2 and 5.3
3038-0009	Large Trader Reports	17 CFR 15.04

Paperwork burdens associated with these entire collections, including the amended rules and their OMB numbers are as follows:

OMB No.		
3038-0024*	Average Burden hours per response	5.52
	Number of Respondents	925
	Frequency of Response	5.03
3038-0022*	Average Burden hours per response	2.1
	Number of Respondents	1322
	Frequency of Response	4.4
3038-0018	Average Burden hours per response	0.35
	Number of Respondents	11
	Frequency of Response	16.18
3038-0016	Average Burden hours per response	250
	Number of Respondents	14
	Frequency of Response	.0714
3038-0009	Average Burden hours per response	0.16
	Number of Respondents	3615
	Frequency of Response	21.6

* Refers only to annual reporting or disclosure burden. The record keeping burden is unaffected by these amendments.

Copies of the OMB approved information collection package associated with these rules may be obtained from Gary Waxman, Office of Management and Budget, room 3220, NEOB, Washington, DC 20503, (202) 395-7340.

List of Subjects

17 CFR Part 1

Commodity futures, Contract markets, Contract market membership lists, Members of contract markets, Reporting and recordkeeping requirements.

17 CFR Part 5

Contract markets, Commodity futures, Designation application, Reporting and recordkeeping requirements.

17 CFR Part 7

Commodity exchanges, Arbitration, Commodity futures.

17 CFR Part 12

Administrative practice and procedure, Commodity exchanges, Commodity futures, Reparations.

17 CFR Part 15

Brokers and large traders, Reporting and recordkeeping requirements.

17 CFR Part 20

Contract markets, Exchanges, Commodity futures, Reporting and recordkeeping, Warehouses.

17 CFR Part 140

Authority Delegations (Government agencies).

17 CFR Part 149

Blind, Civil rights, Deaf, Disabled, Discrimination against handicapped, Equal employment opportunity, Federal buildings and facilities, Handicapped, Nondiscrimination, Physically handicapped.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 2(a) (1), 4, 4a, 4b, 4c, 4d, 4e, 4f, 4g, 4h, 4i, 4k, 4m, 4n, 4o, 5, 5a, 6(a), 6(b), 6b, 6c, 8, 8a, 8c, 12, 15, 17, 19 and 20 thereof, 7 U.S.C. 2, 2a, 4, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 19, 21, 23 and 24, the Commission hereby amends Chapter I of title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 19, 21, 23, and 24, unless otherwise stated.

2. Section 1.17 is amended by revising paragraph (h)(3)(vi) to read as follows:

§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

* * * * *

(h) * * *

(3) * * *

(vi) *Filing.* An applicant shall file a signed copy of any proposed subordination agreement (including nonconforming subordination agreements) with the National Futures Association at least ten days prior to the proposed effective date of the agreement or at such other time as the National Futures Association for good cause shall accept such filing. A registrant that is not a member of any designated self-regulatory organization shall file two signed copies of any proposed subordination agreement (including nonconforming subordination agreements) with the regional office of the Commission nearest the principal place of business of the registrant (except that a registrant under the jurisdiction of the Commission's Western Regional Office shall file such copies with the Commission's Southwestern Regional Office) at least ten days prior to the proposed effective date of the agreement or at such other time as the Commission for good cause shall accept such filing. A registrant that is a member of a designated self-regulatory organization shall file signed copies of any proposed subordination agreement (including nonconforming subordination agreements) with the designated self-regulatory organization in such quantities and at such time as the designated self-regulatory organization may require prior to the effective date. The applicant or registrant shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the applicant or registrant and whether the applicant or registrant carried funds or securities for the lender at or about the time the proposed agreement was so filed. A proposed agreement filed by an applicant with the National Futures Association shall be examined at the National Futures Association, and no such agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the National Futures Association has found the agreement acceptable and such agreement has become effective in the form found acceptable. A proposed agreement filed by a registrant shall be examined at the designated self-regulatory organization with whom such an agreement is required to be filed prior to its becoming effective or, if the registrant is not a member of any designated self-regulatory organization, at the regional office of the Commission where the agreement is required to be filed prior to its becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the designated self-regulatory organization or, if a registrant is not a member of any designated self-regulatory organization, the Commission, has found the agreement acceptable and such agreement has become effective in the form found acceptable.

* * * * *

3. Section 1.41 is amended by revising paragraph (e) to read as follows:

§ 1.41 Contract market rules; submission of rules to the Commission; exemption of certain rules.

* * * * *

(e) *Membership lists.* Upon request of the Commission each contract market shall promptly furnish to the Commission a current list of the contract market's membership.

* * * * *

4. Section 1.43 is revised to read as follows:

§ 1.43 Information required concerning warehouses.

Each contract market shall file upon request by the Commission a list of all warehouses, depositories and other similar entities, in which or out of which commodities are deliverable in satisfaction of futures contracts or options on physicals made on or subject to the rules of such contract market, which list shall show the name, location, and storage capacity of each such warehouse, depository or other similar entity, together with the name and business address of the operator thereof. Each contract market shall require the operator of such warehouse, depository or, other similar entity to furnish, upon request by the Commission, a schedule of storage charges, handling charges, and the annual fire insurance rate applicable to such warehouse, depository or other similar entity.

PART 5—DESIGNATION OF AND CONTINUING COMPLIANCE BY CONTRACT MARKETS

5. The authority citation for part 5 continues to read as follows:

Authority: 7 U.S.C. 6c; 7; 7a; 8 and 12a;

6. Section 5.2(d) introductory text is revised to read as follows:

§ 5.2 Dormant contracts.

* * * * *

(d) *Exemptions.* No contract market shall be considered dormant until the end of sixty (60) complete calendar months:

* * * * *

§ 5.3 [Removed and reserved]

7. Section 5.3 is removed and reserved.

PART 7—CONTRACT MARKET RULES ALTERED OR SUPPLEMENTED BY THE COMMISSION

8. The authority citation for part 7 continues to read as follows:

Authority: 7 U.S.C. 7a(12) and 12a(7).

§ 7.100 [Removed and reserved]

9. Section 7.100 is removed and reserved.

§ 7.101 [Removed and reserved]

10. Section 7.101 is removed and reserved.

Subpart B—[Removed and Reserved]

10A. Subpart B and its heading are reserved.

§ 7.200 [Removed and reserved]

11. Section 7.200 is removed and reserved.

PART 12—RULES RELATING TO REPARATION PROCEEDINGS

12. The authority citation for part 12 continues to read as follows:

Authority: 7 U.S.C. 4a(j), 12a(5), and 18(b).

13. In § 12.2 paragraph (w) is removed and reserved.

§ 12.301 [Removed and reserved]

14. Section 12.301 is removed and reserved.

§ 12.302 [Removed and reserved]

15. Section 12.302 is removed and reserved.

16. In § 12.304 paragraph (d) is removed and reserved.

16a. Section 12.2 is amended by removing and reserving paragraph (d)(4) and revising paragraphs (d)(1), (h), (i)(1), (p) and (r) to read as follows:

§ 12.2 Definitions.

* * * * *

(d) * * *

(1) A Judgment Officer;

* * * * *

(h) *Director of the Office of Proceedings* means an employee of the Commission who shall serve as the administrative head of that Office, with responsibility and authority to assure that the part 12 Reparation Rules are administered in a manner that will effectuate the purposes of section 14(b) of the Act. The Director is authorized to

convene meetings of all personnel in the Office of Proceedings, including Administrative Law Judges and their personally assigned law clerk. The Director shall have the authority to delegate his duties to administer §§ 12.15, 12.24, 12.26 and 12.27 of these rules, and, shall have the authority to assign and, if necessary, reassign the duties of, and set reasonable standards for performance for, all personnel in the Office, including the Judgment Officers, but not including Administrative Law Judges and their personally assigned law clerk;

(i) * * *

(1) A discussion, after consent has been obtained from all of the named parties, between a party and a Judgement Officer or Administrative Law Judge, or the staffs of the foregoing, pertaining solely to the possibility of settling the case without the need for a decision;

* * * * *

(p) *Office of Proceedings* means that office within the Commission comprised of the Administrative Law Judges, Judgment Officers, the Director of that office, the Proceedings Clerk, and members of the staffs of the foregoing, which administers these part 12 Reparation Rules, other than the rules authorizing direct review by the Commission;

* * * * *

(r) *Order* means the whole or any part of a final procedural or substantive disposition of a reparation proceeding by the Commission, an Administrative Law Judge, a Judgment Officer or the Proceedings Clerk;

* * * * *

16b. Section 12.22(b) is revised to read as follows:

§ 12.22 Default proceedings.

* * * * *

(b) *Default procedure.* Upon a party's failure to respond timely to a complaint or counterclaim as prescribed in §§ 12.16 and 12.20 of these rules, or timely to comply with § 12.25 (b) or (c), the Director of the Office of Proceedings shall forward the pleadings, and other materials then of record, to a Judgment Officer or Administrative Law Judge who may thereafter enter findings and conclusions concerning the questions of violations and damages and, if warranted, enter a reparation award against the non-responding party. If the facts which are treated as admitted are considered insufficient to support a violation or the amount of reparations sought, the Judgment Officer or Administrative Law Judge may order production of supplementary evidence from the party not in default and may enter a default order and an award based thereon.

* * * * *

16c. Section 12.303 is amended by revising the introductory text to the section and the concluding text to the section to read as follows:

§ 12.303 Pre-decision conferences.

During the time period permitted for discovery pursuant to § 12.30(d), and thereafter, the Administrative Law Judge may, in his discretion, conduct one or more pre-decision conferences to be held in Washington, DC or by telephone, with all parties for the purposes of:

* * * * *

At or following the conclusion of a pre-decision conference, the Administrative Law Judge my serve a pre-decision memorandum and order setting forth the agreements reached by the parties, any procedural determinations made by him, and the issues for resolution not disposed of by admissions or agreements by the parties. Such an order shall control the subsequent course of the proceeding unless modified to prevent injustice.

17. In 17 CFR part 12 remove the words "Proceedings Officer," in the following places:

a. Section 12.5(a);

b. Section 12.6(a);

c. Section 12.8 (a) and (b);

d. Section 12.10 (a)(3), and (c); and

e. Section 12.408(a)(3).

§ 12.408 [Amended]

17a. In addition to the amendments set forth above, in § 12.408(a)(2) remove the words "Proceedings Officer".

PART 15—REPORTS—GENERAL PROVISIONS

18. The authority citation for part 15 continues to read as follows:

Authority: 7 U.S.C. 2, 4, 6a, 6c(a)–(d), 6f, 6g, 6i, 6k, 6m, 6n, 7, 9, 12a, 19, and 21; 5 U.S.C. 552 and 552(b).

§ 15.04 [Removed and reserved]

19. Section 15.04 is removed and reserved.

PART 20—[REMOVED AND RESERVED]

20. Part 20 is removed and reserved.

PART 140—ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

21. The authority citation for part 140 continues to read as follows:

Authority: 17 U.S.C. 12(a).

§ 140.61 [Removed and reserved]

22. Section 140.61 is removed and reserved.

§ 140.81 [Removed and reserved]

23. Section 140.81 is removed and reserved.

24. Section 140.96 is amended by revising paragraph (b) as follows:

§ 140.96 Delegation of authority to publish in the Federal Register.

* * * * *

(b) The Commodity Futures Trading Commission hereby delegates, until such time as the Commission orders otherwise, to the Director of the Division of Economic Analysis or the Director's designee, and to the Director of the Division of Trading and Markets or the Director's designee, with the concurrence of the General Counsel or the General Counsel's designee, the authority to determine to publish, and to publish, in the **Federal Register**, requests for public comment on proposed exchange and self-regulatory organization rule amendments when publication of the proposed rule amendment is in the public interest and will assist the Commission in considering the views of interested persons.

* * * * *

§§ 140.72, 140.73, 140.77 [Amended]

25. In 17 CFR part 140 remove the words "Division of Economics and Education" and add, in their place, the words "Division of Economic Analysis" in the following places:

a. Section 140.72(a);

b. Section 140.73 (a) introductory text and (b);

c. Section 140.77 (a), (b), and (c).

PART 149—ENFORCEMENT OF NONDISCRIMINATION ON THE BASIS OF HANDICAP IN PROGRAMS OR ACTIVITIES CONDUCTED BY THE COMMODITY FUTURES TRADING COMMISSION

26. The authority citation for part 149 continues to read as follows:

Authority: 29 U.S.C. 794.

§ 149.110 [Removed and reserved]

27. Section 149.110 is removed and reserved.

Issued in Washington, D.C., this 5th day of May, 1992, by the Commodity Futures Trading Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 92–10950 Filed 5–13–92; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8412]

RIN 1545-AM54

Application of Section 904 to Income Subject to Separate Limitations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the application of section 904 with respect to income received or accrued by a taxpayer consisting of income described in section 904(d). Amendments to the final regulations are necessary because of the changes made to the applicable law by the Technical and Miscellaneous Revenue Act of 1988. The regulations provide taxpayers with guidance needed to comply with that Act and with the Tax Reform Act of 1986 and affect individuals and entities claiming the foreign tax credit. In addition, these regulations remove an obsolete provision from the regulations under section 905 of the Internal Revenue Code of 1986.

EFFECTIVE DATE: The amendments to the regulation are effective for taxable years beginning after December 31, 1986.

FOR FURTHER INFORMATION CONTACT: Caren Silver Shein of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224 (attention: CC:CORP:T:R (INTL-0790-88)) (202-566-3452, not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On August 26, 1987, the Internal Revenue Service published in the **Federal Register** proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 904 of the Internal Revenue Code of 1954 (52 FR 32242). On July 18, 1988, the Internal Revenue Service published in the **Federal Register** final regulations under section 904 of the Internal Revenue Code of 1986 (53 FR 27006). The regulations provided rules for determining a taxpayer's foreign tax credit limitations under section 904(d) and conformed the regulations to the Tax Reform Act of 1986 (Pub. L. 99-514, 100 Stat. 2085). The proposed regulations reflected proposed technical corrections. Because the technical corrections bill had not yet been enacted, portions of the final regulations were reserved. The reserved portions have now been added to conform the regulations to section 1012 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647, 102 Stat. 3342). Other amendments and corrections also have been made. Written comments were received with respect to the final regulations. No public hearing was requested or held with respect to those comments. The significant points raised by the comments and the changes made to the final regulations are discussed in the remainder of the preamble. After consideration of the comments received, the amendments are adopted as modified by this Treasury Decision.

Explanation of Provisions

In addition to numerous clarifying and correcting amendments, the following revisions are made to the regulations.

Section 1.904-4

Section 1.904-4(c)(1) is amended to clarify that for purposes of allocating taxes to groups of income, foreign taxes imposed on both United States source and foreign source income are included. In making the determination whether income is high-taxed under the rules of paragraph (c) (the high-tax exception to the passive income category), however, only foreign source income is relevant.

Pursuant to comments, § 1.904-4(c)(5)(ii) is amended to clarify that United States QBUs of United States entities are subject to the grouping rules of paragraph (c)(3), as is a distributive share of income from a United States partnership earned by a United States QBU.

Section 1.904-4(c)(5)(iv) is added to provide a rule for certain dividends that are not taxable under subpart F by reason of section 954(b)(4) (the subpart F high-tax exclusion), but are passive income for foreign tax credit purposes. As an example, such dividends may be passive because of a reduction in the effective rate of tax imposed by a foreign country on the dividend and consequent redetermination of United States income tax liability pursuant to section 905(c). Paragraph (c)(5)(iv) provides that a dividend from a controlled foreign corporation that is treated as passive income under the look through rules shall be grouped, for purposes of determining whether the income is high-taxed, according to the rules of paragraph (c)(4).

Section 1.904-4(c)(7)(ii) is amended to clarify that foreign law controls the year to which a reduction in foreign tax relates, and to provide that the LIFO ordering rules are to apply only when foreign law is not clear. These amendments conform the regulations to section 905(c) and the regulations under that section, which generally look to foreign law to determine the year to which a reduction in tax relates.

Section 1.904-4(c)(6)(ii) has been revised and § 1.904-4(c)(8) has been deleted to be consistent with the regulations under section 905(c). The Service suspended § 1.905-3T(d)(2)(ii)(A), which provided that redeterminations more than 90 days before the due date of a return for the prior taxable year must be reflected on that return. Notice 90-26, 1990-1 C.B. 336. Thus, paragraph (c)(8), which provided that if there is a redetermination of foreign tax within the meaning of section 905(c) more than 90 days before the due date of its income tax return, a taxpayer is required to reflect the income as redetermined on its return for that taxable year, has been deleted. Paragraph (c)(6)(ii) provided two exceptions to the general rule of paragraph (c)(6)(i) that the determination whether a subpart F inclusion is high-taxed is to be made in the year of the inclusion, notwithstanding that the taxpayer is required to pay an additional tax when the previously taxed income is distributed in a later year. The second exception, providing that additional taxes paid on previously taxed income will be taken into account for purposes of applying the high-tax kick out if a distribution is received more than 90 days before the due date of the tax return for the taxable year of the subpart F inclusion, has been deleted.

Section 1.904-4(d) is revised, pursuant to technical corrections, to provide that interest income that is not high withholding tax interest because it is export financing interest shall be treated as general limitation income unless it is received by a financial services entity, in which case it will be financial services income.

Paragraphs (e)(1) and (5) (i) and (ii) of § 1.904-4, which had been reserved, are added. Paragraph (e)(1) defines the term "financial services income" and paragraphs (e)(5) (i) and (ii) describe income that is excluded from the definition of financial services income.

The Service has clarified § 1.904-4(e)(2)(i)(V) by defining a finance lease based on generally accepted accounting standards used to distinguish a finance lease from an operating lease. A finance lease, for purposes of section 904(d), is defined by these regulations to be a direct financing lease or a leveraged lease for accounting purposes that is also a lease for tax purposes. A lease

that produces active rental income excludible from subpart F pursuant to section 954(c)(2)(A) is not a finance lease and the rental income earned from that lease would not be active financing income. As a result of this change, the rule in § 1.904–4(e)(3)(ii) providing that leasing income of any member of the group will not be considered active financing income if any member of the recipient's group satisfies the active trade or business requirements of section 954(c)(2) (A) with respect to that income is unnecessary and, therefore, is deleted.

Section 1.904–4(f) is revised to correct an oversight in the final regulations. Income that falls into both the shipping and foreign trade income categories will be treated as foreign trade income.

Formerly reserved § 1.904–4(g)(2)(iv) is added to provide that an inclusion in gross income under section 1293 with respect to a noncontrolled section 902 corporation shall be treated as a dividend from a noncontrolled section 902 corporation.

Section 1.904–4(h)(2) and (3) is revised and the reserved paragraphs of § 1.904–4(h)(3) are added. Paragraph (h)(3) provides exceptions to the general rule for the treatment of export financing interest provided in paragraph (h)(2).

The **Federal Register** published proposed revised regulations under §§ 1.904–4(j), 1.954–2T(g) and 1.985–3(d) on July 10, 1991 (56 FR 31362). Those regulations are proposed to be effective prospectively. The Service, therefore, is leaving § 1.904–4(j) in place until the proposed regulations are effective.

A new § 1.904–4(k) is added to provide a rule for characterizing income for purposes of computing the alternative minimum tax ("AMT") foreign tax credit under section 59(a). For taxable years beginning after 1989, alternative minimum taxable income ("AMTI") is increased by 75 percent of the excess of AMTI computed without the adjustment based on adjusted current earnings (the "ACE adjustment") and AMTI computed with the ACE adjustment. Section 56(g). In computing the AMT foreign tax credit, the rules of section 904 apply except that AMTI is substituted for taxable income. Section 59(a)(1)(B). Commenters have suggested that for purposes of determining the character of income under section 904(d), the ACE adjustment should be viewed as an item of income. Because the ACE adjustment is not described in any other category, it would be included in the residual or general limitation basket. The Service does not adopt such a rule. Congress did not intend that all ACE adjustments be made to the general limitation basket. The legislative history indicates that items included in AMTI by reason of the ACE adjustment are to be sourced for section 904 purposes on an item-by-item basis. See H.R. Rep. (Conf.) 841, 99th Cong., 2d Sess. II–282 (1986). Once the ACE adjustment has been divided into its component parts for sourcing purposes, the character or basket of each foreign source component also should be determined on an item-by-item basis under section 904(d). Thus, paragraph (k) has been added to provide that an item included in AMTI by reason of the ACE adjustment is to be characterized for purposes of section 904(d) based on the character of the underlying item of income.

Formerly reserved § 1.904–4(k) is added as new paragraph (1) to provide priority rules in the case of income that meets the definitions of more than one category of separate limitation income.

Section 1.904–5

A commenter suggested that the Service amend § 1.904–5(a)(3) to change the definition of an affiliated group to include foreign corporations. This would allow look-through treatment for foreign source payments between related United States entities who are not part of the same affiliated group because a nonincludible corporation such as a foreign corporation has been inserted between them in the chain of ownership. Such corporations in most cases are disaffiliated for tax planning reasons. There is no indication that Congress intended to provide look-through treatment in such cases.

Formerly reserved § 1.904–5(d)(1) is added to provide that if a controlled foreign corporation satisfies the de minimis rule of section 954(b)(5), all of the controlled foreign corporation's gross foreign base company income and gross insurance income, other than income that would be financial services income, shall be treated as general limitation income.

Several commenters requested that § 1.904–5(g) be expanded to provide look-through treatment for foreign source dividends paid by a U.S. corporation to a related U.S. corporation. Section 1.904–5(g) currently provides look-through treatment only for foreign source interest, rents and royalties paid by a U.S. corporation to a related U.S. corporation. The problem concerns section 936 corporations and the alternative minimum tax ("AMT") foreign tax credit. For regular tax purposes, dividends received from a section 936 corporation by a related U.S. corporation are entitled to a 100% dividends received deduction and taxes paid on that income are not treated as foreign income taxes. Section 243(a)(3). For AMT purposes after 1989, however, there is no deduction and the dividend is added back in calculating the taxpayers adjusted current earnings. section 56(g)(4)(C)(ii).

Dividends paid by a section 936 corporation are foreign source under section 861(a)(2)(A) and are characterized as passive income under section 904(d)(2)(A). Commenters argue that because a section 936 corporation must derive 75 percent of its income from an active trade or business (section 936(a)(2)(B)), it is inappropriate to retain dividends received from a section 936 corporation in the passive basket. Dividends from a section 936 corporation, however, are virtually always subject to a low rate of tax. Providing look-through would permit averaging of high and low-taxed income. Where low-taxed foreign source income such as a dividend from a section 936 corporation is already separately identified for other Code purposes, permitting averaging of such income with high-taxed foreign source income is inappropriate. The comment, therefore, is rejected.

The temporary and proposed regulations under section 864(e) (5) and (6) currently provide that a section 936 corporation is a member of the affiliated group for purposes of allocating and apportioning interest and certain other expenses. See §§ 1.861–1T(d) and 1.861–14T(d). The proposed regulations (but not the temporary regulations) are proposed to be amended (in a separate document (INTL–0001–92)) to exclude section 936 corporations from the affiliated group solely for purposes of determining foreign source alternative minimum taxable income and the AMT foreign tax credit. The intended result of the proposed amendments is to increase the proportion of interest and certain other expenses apportioned to foreign source passive income, and to reduce the proportion of those expenses apportioned to foreign source general limitation income, in each case solely for AMT purposes. For taxpayers subject to the AMT, these adjustments are intended to provide expense allocation rules consistent with the treatment of dividends paid by a section 936 corporation as foreign source passive income. For further discussion of the proposed amendments to the interest and other expense allocation and apportionment rules under section 864(e) (5) and (6), see INTL–0001–92.

Section 1.904–5(h)(3), which had been reserved, is added to provide that if a partner recognizes gain on the sale of a partnership interest, that income shall

be treated as passive income to the partner, unless the income is high taxed.

A commenter suggested that an active trade or business exception be added to the rule of § 1.904–5(h)(3) that gain on the sale of a partnership interest is passive. Specifically, the commenter suggested that if a partner holds an interest in an oil and gas joint venture or partnership and the partner is regularly, actively and substantially engaged in the exploration for and extraction of minerals either directly or through the joint venture or partnership, then the partner should be entitled to look-through treatment on the disposition of the interest. The commenter noted that most foreign countries in which oil and gas exploration occurs require foreign investors to operate through a partnership or joint venture. Such investors thus do not have the option of operating in corporate form in order to obtain look-through treatment on disposition of their interests.

There is no statutory authority to add the suggested exception. Section 954(c)(1) defines foreign personal holding company income as, among other things, royalties, rents, and gain on the sale of a partnership interest. Section 954(c)(2) provides an active trade or business exception for rents and royalties derived from the active conduct of a trade or business. No exception is provided for gain on the sale of a partnership interest in which the partner was an active participant.

In the final regulations published in 1988, paragraph (i)(3) was reserved on the issue whether to extend look-through to payments from foreign parents to United States subsidiaries. The Service has decided not to allow look-through on payments from a foreign parent to a United States subsidiary. To apply the look-through rules, the Service needs complete information concerning the foreign corporation's income and expenses. The Service may not be able to obtain all of the necessary information from a foreign parent corporation and to audit it. In addition, the payments generally would be deductible from taxable income of the payor that is entirely outside the jurisdiction of the United States (including subpart F) and, therefore, do not give rise to the same concerns involved in other look-through cases.

Section 1.904–5(j), which had been reserved, is added to provide that the look-through rules apply to amounts included in the gross income of a United States shareholder of a passive foreign investment company under section 1293 if that company is also a controlled foreign corporation.

Formerly reserved § 1.904–5(m)(7) is added to provide a special rule for income that would be United States source income under section 904(g), but is treated as foreign source income under an income tax convention with the United States and the taxpayer elects the benefits of the treaty pursuant to section 904(g)(10). Paragraph (m)(7) provides that if the taxpayer elects the benefits of the treaty, the income shall be treated as foreign source but the foreign tax credit rules shall be applied separately with respect to income treated as foreign source pursuant to each treaty under which the taxpayer has claimed benefits. Thus, the taxpayer must segregate income treated as foreign source under each treaty and then allocate the income within each treaty to a separate group of section 904(d) categories. For example, a taxpayer may not average general limitation income treated as foreign source under one treaty with general limitation income treated as foreign source under another treaty. A taxpayer also may not average general limitation income treated as foreign source under a treaty with passive income treated as foreign source under the same treaty.

Section 1.904–6

Section 1.904–6(a)(1)(iv) is added to provide special rules for items that are taxed under foreign law but are not income for United States purposes, and for items that are income for United States purposes, but are subject to a foreign tax in a year other than the year in which they would be income under United States tax principles. Paragraph (a)(1)(iv) provides two rules. First, if a foreign country imposes a tax on income that would not be income for United States purposes, the tax shall be treated as imposed with respect to general limitation income. Second, if the foreign country imposes a tax on an item in one year that would be recognized under United States tax principles in another year, the tax must be allocated among the separate categories as if the income were recognized under United States principles in the year in which the tax was imposed.

Section 1.904–6(a)(2) is revised to provide that if a taxpayer receives or accrues a dividend from a noncontrolled section 902 corporation, and there is an express or implied agreement that the dividend is to be paid out of earnings that would be subject to the separate limitation for passive income or high withholding tax interest, then only foreign income taxes imposed on passive or high withholding tax interest income will be considered taxes relating to the dividend.

Section 1.904–6(b)(2)(i) is amended in response to a comment to provide that the rule shall be applicable to individual as well as corporate shareholders.

Section 1.904–7

Section 1.904–7(a) is revised pursuant to comments to provide that the transition rules for characterizing income derived by a controlled foreign corporation in taxable years beginning before January 1, 1987, and distributed to or included in the gross income of a United States shareholder in a taxable year beginning after December 31, 1986, apply to distributions and section 951(a)(1)(A) (ii) and (iii) and (B) inclusions.

Paragraph (a) is revised further, in response to comments, to clarify that the transition rules of § 1.904–7 apply only if the controlled foreign corporation was a controlled foreign corporation at the time the income to be distributed to or included by the United States shareholder was accumulated by the controlled foreign corporation. Section 1.904–7(a) provides transition rules for applying the § 1.904–5 look-through rules when earnings accumulated in a pre-1987 year are distributed or included in a post-1986 year. The look-through rules apply only to controlled foreign corporations. Thus, the transition rules also apply only if a corporation was a controlled foreign corporation in the year in which the income distributed or included was earned.

Section 1.905–2

Paragraph (c) of § 1.905–2 has been removed because it interprets a provision that is no longer in the Internal Revenue Code.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It also has been determined that section 553(b) of the Administrative Procedure 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 final Regulatory Flexibility Analysis is not required by the Regulatory Flexibility Act.

Drafting Information

The principal author of these regulations is Caren Silver Shein of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, Internal Revenue Service. Other personnel from the Internal Revenue Service and Treasury

Department participated in developing the regulations.

List of Subjects in 26 CFR 1.901–1 Through 1.905–5T

Income taxes, Reporting and recordkeeping requirements, United States investments abroad.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority citation for part 1 continues to read in part:

Authority: 26 U.S.C. 7805 * * * Sections 1.904–4 through 1.904–7 also issued under 26 U.S.C. 904(d)(5). * * *

Par. 2. Section 1.904–0 is revised to read as follows:

§ 1.904–0 Outline of regulation provisions for section 904.

This section lists the revised paragraphs contained in §§ 1.904–1 through 1.904–7, 1.904(b)–1 through 1.904(b)–4, 1.904(f)–1 through 1.904(f)–6 and 1.904(f)–12.

§ 1.904–1 Limitation on credit for foreign taxes.

(a) Per-country limitation.
(1) General.
(2) Illustration of principles.
(b) Overall limitation.
(1) General.
(2) Illustration of principles.
(c) Special computation of taxable income.
(d) Election of overall limitation.
(1) In general.
(i) Manner of making election.
(ii) Revocation for first taxable year beginning after December 31, 1969.
(2) Method of making the initial election.
(3) Method of revoking an election and making a new election.
(e) Joint return.
(1) General.
(2) Electing the overall limitation.

§ 1.904–2 Carryback and carryover of unused foreign tax.

(a) Credit for foreign tax carryback or carryover.
(b) Years to which carried.
(1) General.
(2) Definitions.
(3) Taxable years beginning before January 1, 1958.
(c) Tax deemed paid or accrued.
(1) Unused foreign tax for per-country limitation year.
(2) Unused foreign tax for overall limitation year.
(3) Unused foreign tax with respect to foreign mineral income.
(d) Determination of excess limitation for certain years.
(e) Periods of less than 12 months.
(f) Statement with tax return.
(g) Illustration of carrybacks and carryovers.

§ 1.904–3 Carryback and carryover of unused foreign tax by husband and wife.

(a) In general.
(b) Joint unused foreign tax and joint excess limitation.
(c) Continuous use of joint return.
(d) From separate to joint return.
(e) Amounts carried from or through a joint return year to or through a separate return year.
(f) Allocation of unused foreign tax and excess limitation.
(1) Limitation.
(i) Per-country limitation.
(ii) Overall limitation.
(2) Unused foreign tax.
(i) Per-country limitation.
(ii) Overall limitation.
(3) Excess limitation.
(i) Per-country limitation taxpayer.
(ii) Overall limitation.
(4) Excess limitation to be applied.
(5) Reduction of excess limitation.
(6) Spouses using different limitations.
(g) Illustrations.

§ 1.904–4 Separate application of section 904 with respect to certain categories of income.

(a) In general.
(b) Passive income.
(1) In general.
(i) Rule.
(ii) Example.
(2) Active rents or royalties.
(i) In general.
(ii) Exception for certain rents and royalties.
(iii) Unrelated person.
(iv) Example.
(c) High-taxed income.
(1) In general.
(2) Grouping of items of income in order to determine whether passive income is high-taxed income.
(i) Effective date.
(ii) Allocation and apportionment of expenses.
(3) Amounts received or accrued by United States persons.
(4) Income of controlled foreign corporations and foreign QBUs.
(5) Special rules.
(i) Certain rents and royalties.
(ii) Treatment of partnership income.
(iii) Currency gain or loss.
(iv) Certain passive dividends.
(6) Application of this paragraph to additional taxes paid or deemed paid in the year of receipt of previously taxed income.
(i) Determination made in year of inclusion.
(ii) Exception.
(iii) Allocation of foreign taxes imposed on distributions of previously taxed income.
(iv) Increase in taxes paid by successors.
(7) Application of this paragraph to certain reductions of tax on distributions of income.
(i) In general.
(ii) Allocation of reductions of foreign tax.
(iii) Interaction with section 954(b)(4).
(8) Examples.
(d) High withholding tax interest.
(e) Financial services income.
(1) In general.
(2) Active financing income.
(i) Income included.
(3) Financial services entities.
(i) In general.
(ii) Special rule for affiliated groups.
(iii) Treatment of partnerships and other pass-through entities.
(A) Rule.
(B) Examples.
(iv) Examples.
(4) Definition of incidental income.
(i) In general.
(A) Rule.
(B) Examples.
(ii) Income that is not incidental income.
(5) Exceptions.
(f) Shipping income.
(g) Non-controlled section 902 corporations.
(1) Definition.
(2) Treatment of dividends for each separate noncontrolled section 902 corporation.
(i) In general.
(ii) Special rule for dividends received by a controlled foreign corporation.
(iii) Special rule for high withholding tax interest.
(iv) Treatment of inclusions under section 1293.
(3) Special rule for controlled foreign corporations.
(i) General rule.
(ii) Dividend distributions out of earnings and profits for a year during which a shareholder that is currently a more-than-90-percent United States shareholder was not a United States shareholder.
(iii) Ordering rule.
(iv) Examples.
(4) Examples.
(h) Export financing interest.
(1) Definitions.
(i) Export financing.
(ii) Fair market value.
(iii) Related person.
(2) Treatment of export financing interest.
(3) Exceptions.
(i) Export financing interest that is high withholding tax interest.
(ii) Export financing interest that is also related person factoring income.
(iii) Export financing interest that is related person factoring income and is received or accrued by a financial services entity.
(iv) Export financing interest that is related person factoring income and high withholding tax interest.
(4) Examples.
(5) Income eligible for section 864(d)(7) exception (same country exception) from related person factoring treatment.
(i) Income other than interest.
(ii) Interest income.
(iii) Examples.
(i) Interaction of section 907(c) and income described in this section.
(j) Special rule for certain currency gains and losses.
(k) Special rule for alternative minimum tax foreign tax credit.
(l) Priority rules.

(1) In general.
(2) Examples.

§ 1.904–5 Look-through rules as applied to controlled foreign corporations and other entities.

(a) Definitions.
(b) In general.
(c) Rules for specific types of inclusions and payments.
(1) Subpart F inclusions.
(i) Rule.
(ii) Examples.
(2) Interest.
(i) In general.
(ii) Allocating and apportioning expenses including interest paid to a related person.
(iii) Definitions.
(A) Value of assets and reduction in value of assets and gross income.
(B) Related person debt allocated to passive assets.
(iv) Examples.
(3) Rents and royalties.
(4) Dividends.
(i) Look-through rule.
(ii) Special rule for dividends attributable to certain loans.
(iii) Examples.
(d) Effect of exclusions from Subpart F income.
(1) De minimis amount of Subpart F income.
(2) Exception for certain income subject to high foreign tax.
(3) Examples.
(e) Treatment of Subpart F income in excess of 70 percent of gross income.
(1) Rule.
(2) Example.
(f) Modifications of look-through rules for certain income.
(1) High withholding tax interest.
(2) Dividends from a non-controlled section 902 corporation.
(i) Rule.
(ii) Example.
(3) Distributions from a FSC.
(4) Example.
(g) Application of the look-through rules to certain domestic corporations.
(h) Application of the look-through rules to partnerships and other pass-through entities.
(1) General rule.
(2) Exception for certain partnership interests.
(i) Rule.
(ii) Exceptions.
(3) Income from the sale of a partnership interest.
(4) Value of a partnership interest.
(i) Application of look-through rules to related entities.
(1) In general.
(2) Exception for distributive shares of partnership income.
(3) Special rule for dividends.
(4) Examples.
(j) Look-through rules applied to passive foreign investment company inclusions.
(k) Ordering rules.
(1) In general.
(2) Specific rules.
(l) Examples.
(m) Application of section 904(g).
(1) In general.
(2) Treatment of interest payments.
(3) Examples.
(4) Treatment of dividend payments.
(i) Rule.
(ii) Determination of earnings and profits from United States sources.
(iii) Example.
(5) Treatment of Subpart F inclusions.
(i) Rule.
(ii) Example.
(6) Treatment of section 78 amount.
(7) Coordination with treaties.
(i) Rule.
(ii) Example.
(n) Order of application of sections 904 (d) and (g).
(o) Effective date.

§ 1.904–6 Allocation and apportionment of taxes.

(a) Allocation and apportionment of taxes to a separate category or categories of income.
(1) Allocation of taxes to a separate category or categories of income.
(i) Taxes related to a separate category of income.
(ii) Apportionment of taxes related to more than one separate category.
(iii) Apportionment of taxes for purposes of applying the high tax income test.
(iv) Special rule for base and timing differences.
(2) Treatment of certain dividends from noncontrolled section 902 corporations.
(b) Application of paragraph (a) to sections 902 and 960.
(1) Determination of foreign taxes deemed paid.
(2) Distributions received from foreign corporations that are excluded from gross income under section 959(b).
(3) Application of section 78.
(4) Increase in limitation.
(c) Examples.

§ 1.904–7 Transition rules.

(a) Characterization of distributions and section 951(a)(1)(A) (ii) and (iii) and (B) inclusions of earnings of a controlled foreign corporation accumulated in taxable years beginning before January 1, 1987, during taxable years of both the payor controlled foreign corporation and the recipient which begin after December 31, 1986.
(1) Distributions and section 951(a)(1)(A) (ii) and (iii) and (B) inclusions.
(2) Limitation on establishing the character of earnings and profits.
(b) Application of look-through rules to distributions (including deemed distributions) and payments by an entity to a recipient when one's taxable year begins before January 1, 1987 and the other's taxable year begins after December 31, 1986.
(1) In general.
(2) Payor of interest, rents, or royalties is subject to the Act and recipient is not subject to the Act.
(3) Recipient of interest, rents, or royalties is subject to the Act and payor is not subject to the Act.
(4) Recipient of dividends and subpart F inclusions is subject to the Act and payor is not subject to the Act.
(5) Examples.
(c) Installment sales.
(d) Special effective date for high withholding tax interest earned by persons with respect to qualified loans described in section 1201(e)(2) of the Act.
(e) Treatment of certain recapture income.

§ 1.904(b)–1 Treatment of capital gains for corporations.

(a) In general.
(1) Inclusion in foreign source taxable income.
(2) Inclusion in entire taxable income.
(3) Treatment of capital losses.
(b) Definitions.
(1) Capital gain net income.
(2) Foreign source capital gain net income.
(3) Net capital gain.
(4) Foreign source net capital gain.
(5) Rate differential portion.
(6) Net capital loss.
(7) Allocation and apportionment.
(8) Computation of net section 1231 gain.
(c) Illustrations.

§ 1.904(b)–2 Treatment of capital gains for other taxpayers.

(a) In general.
(1) Inclusion in foreign source taxable income.
(2) Inclusion in entire taxable income
(3) Treatment of capital losses.
(b) Definition of net capital loss.
(c) Illustrations.

§ 1.904(b)–3 Sale of personal property.

(a) General rule.
(b) Special rules.
(c) Exception.
(d) Application of source rules.
(e) Gain from liquidation of certain foreign corporations.
(f) Residence defined.
(g) Tax rate applicable to gain.
(h) Country in which gross income derived.

§ 1.904(b)–4 Effective date.

§ 1.904(f)–1 Overall foreign loss and the overall foreign loss account.

(a) Overview of regulations.
(b) Overall foreign loss accounts.
(c) Determination of a taxpayer's overall foreign loss.
(1) Overall foreign loss defined.
(2) Separate limitation defined.
(3) Method of allocation and apportionment of deductions.
(d) Additions to the overall foreign loss account.
(1) General rule.
(2) Overall foreign net capital loss.
(3) Overall foreign losses of another taxpayer.
(4) Additions to overall foreign loss account created by loss carryovers.
(5) Adjustments.
(i) Adjustment due to reduction in foreign source income under section 904(b).
(ii) Adjustment to account for rate differential between ordinary income rate and capital gain rate.

(e) Reductions of overall foreign loss accounts.
(1) Pre-recapture reduction for amounts allocated to other taxpayers.
(2) Reduction for amounts recaptured.
(f) Illustrations.

§ 1.904(f)–2 Recapture of overall foreign losses.

(a) In general.
(b) Determination of taxable income from sources without the United States for purposes of recapture.
(1) In general.
(c) Section 904(f)(1) recapture.
(1) In general.
(2) Election to recapture more of the overall foreign loss than is required under paragraph (c)(1).
(3) Special rule for recapture of losses incurred prior to section 936 election.
(4) Recapture of pre-1983 overall foreign losses determined on a combined basis.
(5) Illustrations.
(d) Recapture of overall foreign losses from dispositions under section 904(f)(3).
(1) In general.
(2) Treatment of net capital gain.
(3) Dispositions where gain is recognized irrespective of section 904(f)(3).
(4) Dispositions in which gain would not otherwise be recognized.
(i) Recognition of gain to the extent of the overall foreign loss account.
(ii) Basis adjustment.
(iii) Recapture of overall foreign loss to the extent of amount recognized.
(iv) Priorities among dispositions in which gain is deemed to be recognized.
(5) Definitions.
(i) Disposition.
(ii) Property used in a trade or business.
(iii) Property used predominantly outside the United States.
(iv) Property which is a material factor in the realization of income.
(6) Carryover of overall foreign loss accounts in a corporate acquisition to which section 381(a) applies.
(7) Illustrations.

§ 1.904(f)–3 Allocation of net operating losses and net capital losses.

(a) Allocation of net operating loss carrybacks and carryovers that include overall foreign losses.
(b) Allocation of net capital loss carrybacks and carryovers that include overall foreign losses.
(c) Transitional rule.
(d) Illustrations.

§ 1.904(f)–4 Recapture of foreign losses out of accumulation distributions from a foreign trust.

(a) In general.
(b) Effect of recapture on foreign tax credit limitation under section 667(d).
(c) Recapture if taxpayer deducts foreign taxes deemed distributed.
(d) Illustrations.

§ 1.904(f)–5 Special rules for recapture of overall foreign losses of a domestic trust.

(a) In general.
(b) Recapture of trust's overall foreign loss.
(1) Trust accumulates income.
(2) Trust distributes income.
(3) Trust accumulates and distributes income.
(c) Amounts allocated to beneficiaries.
(d) Section 904(f)(3) dispositions to which § 1.904(f)–2(d)(4)(i) is applicable.
(e) Illustrations.

§ 1.904(f)–6 Transitional rule for recapture of FORI and general limitation overall foreign losses incurred in taxable year beginning before January 1, 1983, from foreign source taxable income subject to the general limitation in taxable years beginning after December 31, 1982.

(a) General Rule.
(b) Recapture of pre-1983 FORI and general limitation overall foreign losses from post-1982 income.
(1) Recapture from income subject to the same limitation.
(2) Recapture from income subject to the other limitation.
(c) Coordination of recapture of pre-1983 and post-1982 overall foreign losses.
(d) Illustrations.

§ 1.904(f)–12 Transition rules.

(a) Recapture in years beginning after December 31, 1986, of overall foreign losses incurred in taxable years beginning before January 1, 1987.
(1) In general.
(2) Rule for general limitation losses.
(i) In general.
(ii) Exception.
(3) Priority of recapture of overall foreign losses incurred in pre-effective date taxable years.
(4) Examples.
(b) Treatment of overall foreign losses that are part of net operating losses incurred in pre-effective date taxable years which are carried forward to post-effective date taxable years.
(1) Rule.
(2) Example.
(c) Treatment of overall foreign losses that are part of net operating losses incurred in post-effective date taxable years which are carried back to pre-effective date taxable years.
(1) Allocation to analogous income category.
(2) Allocation to U.S. source income.
(3) Allocation to other separate limitation categories.
(4) Examples.
(d) Recapture of FORI and general limitation overall foreign losses incurred in taxable years beginning before January 1, 1983.
(e) Recapture of pre-1983 overall foreign losses determined on a combined basis.
(f) Transition rules for taxable years beginning before December 31, 1990.

Par. 3. Section 1.904–4 is amended as follows:

1. Paragraph (b)(1)(i) concluding text is amended by removing the last sentence and adding three sentences in its place.

2. Paragraph (b)(2)(i) is amended by removing "§ 1.954–2(d)(1)" and adding in its place "section 954(c)(2)(A) and the regulations under that section".

3. Paragraph (b)(2)(iv) is amended by removing "§ 1.954–2(d)(1)" in the *Example* and adding in its place "section 954(c)(2)(A) and the regulations under that section".

4. Paragraph (c)(1) is amended by removing the last sentence and adding four sentences in its place.

5. Paragraph (c)(2)(ii) is amended by removing "§ 1.861–8" and adding in its place "§§ 1.861–8 through 1.861–14T".

6. The heading and introductory text to paragraph (c)(4) are revised.

7. Paragraphs (c)(5) (ii) and (iii) are revised, and a new paragraph (c)(5)(iv) is added.

8. Paragraph (c)(6)(ii) is revised.

9. Paragraph (c)(7)(ii) is amended by removing the second sentence and adding two sentences in its place, and paragraph (c)(7)(iii) is amended by adding a new sentence at the end of the paragraph.

10. Paragraph (c)(8) is removed, paragraph (c)(9) is redesignated paragraph (c)(8), and newly designated paragraph (c)(8) is amended by:

a. Revising *Example (4);*

b. Amending *Example (5)* by inserting "(not including the section 78 amount)" after "$80" in the second sentence, and by removing the language "after P has filed its return for its 1988 tax year," in the eighth sentence;

c. Removing *Example (6), Example (7)* and *Example (12);*

d. Redesignating *Example (8)* through *Example (11)* as *Example (6)* through *Example (9)*, respectively;

e. Amending newly designated *Example (7)* and *Example (8)* by removing the references *"Example (8)"* and adding in their place *"Example (6)"*;

f. Amending newly designated *Example (9)* (ii) by adding "(the reduction in tax rates from 50 percent to 30 percent is a 40 percent reduction in tax)" after "40 percent" in the seventh sentence; and

g. Adding a new *Example (10).*

11. Paragraph (e)(1) is revised.

12. Paragraph (e)(2)(i)(V) is revised.

13. Paragraph (e)(3)(i) is amended by:

a. Adding "at least" before "80 percent" in the third sentence;

b. Adding after the sixth sentence "*See* paragraph (e)(3)(iv) *Example (5)* of this section."; and

c. Adding a sentence at the end of the paragraph.

14. Paragraph (e)(3)(ii) is amended by removing the fourth sentence.

15. Paragraph (e)(3)(iii) is amended by:

a. Removing the designation (A) and removing the heading *"Rule."*;

b. Redesignating paragraph (e)(3)(iii)(B) as paragraph (e)(3)(iv);

c. Removing the reference "paragraph (e)(3)(iii)" in the introductory paragraph of newly designated paragraph (e)(3)(iv) and adding "paragraph (e)(3)" in its place;

d. In newly designated paragraph (e)(3)(iv), redesignating *Examples (1)* and *(2)* as *Examples (3)* and *(4)*, respectively, and adding new *Examples (1), (2)* and *(5)*.

16. Paragraphs (e)(5) (i) and (ii) are added.

17. Paragraph (f) is amended by removing the last sentence and adding a new sentence in its place.

18. Paragraph (g)(1) is amended by adding "Except as provided in section 902 and the regulations under that section and paragraph (g)(3) of this section, a controlled" in place of "A controlled" at the beginning of the second sentence.

19. Paragraph (g)(2)(ii)(A) is amended by adding "that is not a controlled foreign corporation" after "foreign corporation" and before "is", and by adding at the end of paragraph (g)(2)(ii)(A) the language "see paragraph (g)(4) *Example (1)*."

20. Paragraph (g)(2)(iv) is revised.

21. Paragraph (g)(3) is amended by:

a. Adding the language "—(i) *General rule*." at the end of the heading; and

b. Adding and reserving paragraphs (g)(3) (ii), (iii) and (iv).

22. Paragraph (g)(4) is amended by:

a. Amending *Example (2)* by adding "section 904(d)(2)(E)(i) and" before "paragraph (g)(3)" in the last sentence; and

b. Amending *Example (3)* by removing the reference "paragraph (g)(3)" in the ninth sentence and adding in its place "paragraph (g)(2)(iii)".

23. Paragraph (h)(2) is revised.

24. Paragraph (h)(3) is amended by:

a. Revising the heading and paragraphs (h)(3) (i) through (iii);

b. Redesignating paragraphs (iv) and (v) as paragraphs (h)(4) and (h)(5), respectively; and

c. Adding a new paragraph (iv).

25. Newly designated paragraph (h)(4) is amended by:

a. Revising the introductory text;

b. Adding "is not a financial services entity and" in the second sentence of *Example (1)* after "S" and before "has";

c. Adding text to *Example (2)*; and

d. Adding "is not a financial services entity and" in the second sentence of *Example (3)* after "S" and before "has".

26. Newly designated paragraph (h)(5) is amended by:

a. Redesignating paragraphs (h)(5) (A), (B) and (C) as paragraphs (h)(5) (i), (ii) and (iii), respectively;

b. Adding a sentence at the end of newly designated paragraph (h)(5)(i);

c. Adding a sentence at the end of newly designated paragraph (h)(5)(ii); and

d. Revising the introductory text and *Example (1)*, and adding text to *Examples (2)* and *(4)* of newly designated paragraph (h)(5)(iii).

27. Paragraph (k) is revised.

28. Paragraph (l) is added.

29. The revised, redesignated, reserved and added provisions read as follows:

§ 1.904–4 Separate application of section 904 with respect to certain categories of income.

* * * * *

(b) * * *

(1) * * *

(i) * * *

* * * In addition, passive income does not include any income that would otherwise be passive but is characterized as income in another separate category under the lookthrough rules. In determining whether any income is of a kind that would be foreign personal holding company income, the rules of section 864(d)(5)(A)(i) and (6) (treating related person factoring income of a controlled foreign corporation as foreign personal holding company income that is not eligible for the export financing income exception to the separate limitation for passive income) shall apply only in the case of income of a controlled foreign corporation (as defined in section 957). Thus, income earned directly by a United States person that is related person factoring income may be eligible for the exception for export financing interest.

* * * * *

(c) * * *

(1) * * * Income and taxes shall be translated at the appropriate rates, as determined under sections 986, 987 and 989 and the regulations under those sections, before application of this paragraph. For purposes of allocating taxes to groups of income, United States source passive income is treated as any other passive income. In making the determination whether income is high-taxed, however, only foreign source income, as determined under United States tax principles, is relevant. See paragraph (c)(8) *Example (10)* this section for an example illustrating the application of this paragraph (c)(1).

* * * * *

(4) *Income of controlled foreign corporations and foreign QBUs.* Except as provided in paragraph (c)(5) of this section, all amounts included in gross income of a United States shareholder under section 951(a)(1) for a particular year that (after application of the look-through rules of section 904(d)(3) and § 1.904–5) are attributable to passive income received or accrued by a controlled foreign corporation and all amounts of passive income received or accrued by a United States person through a foreign QBU shall be subject to the rules of this paragraph (c)(4). This paragraph (c)(4) shall be applied separately to inclusions with respect to each controlled foreign corporation of which the taxpayer is a United States shareholder. This paragraph (c)(4) also shall be applied separately to income attributable to each QBU of a controlled foreign corporation or any other look-through entity as defined in § 1.904–5(i), except that if the entity subject to the look-through rules is a United States person, then this paragraph (c)(4) shall be applied separately only to each foreign QBU of that United States person.

* * * * *

(5) * * *

(ii) *Treatment of partnership income.* A partner's distributive share of income from a foreign or United States partnership that is not subject to the look-through rules and that is treated as passive income under § 1.904–5(h)(2)(i) (generally providing that a less than 10 percent partner's distributive share of partnership income is passive income) shall be treated as a single item of income and shall not be grouped with other amounts. A distributive share of income from a foreign partnership that is treated as passive income under the look-through rules shall be grouped according to the rules in paragraph (c)(4) of this section. A distributive share of income from a United States partnership that is treated as passive income under the look-through rules shall be grouped according to the rules in paragraph (c)(3) of this section, except that the portion, if any, of the distributive share of income attributable to income earned by a United States partnership through a foreign QBU shall be grouped under the rules of paragraph (c)(4) of this section.

(iii) *Currency gain or loss*—(A) *Section 986(c).* Any currency gain or loss with respect to a distribution received by a United States shareholder (other than a foreign QBU of that shareholder) of previously taxed earnings and profits that is recognized under section 986(c) and that is treated as an item of passive income shall be subject to the rules provided in paragraph (c)(3)(iii) of this section. If that item, however, is received or accrued by a foreign QBU of the United States shareholder, it shall be treated as an item of passive income from sources within the QBU's country

of operation for purposes of paragraph (c)(4)(i) of this section. This paragraph (c)(5)(iii)(A) shall be applied separately for each foreign QBU of a United States shareholder.

(B) *Section 987(3).* Any currency gain or loss with respect to remittances or transfers of property between QBUs of a United States shareholder that is recognized under section 987(3)(B) and that is treated as an item of passive income shall be subject to the rules provided in paragraph (c)(3)(iii) of this section. If that item, however, is received or accrued by a foreign QBU of the United States shareholder, it shall be treated as an item of passive income from sources within the QBU's country of operation for purposes of paragraph (c)(4)(i) of this section. This paragraph (c)(5)(iii)(B) shall be applied separately for each foreign QBU of a United States shareholder.

(C) *Example.* The following example illustrates the provisions of this paragraph (c)(5)(iii).

Example. P, a domestic corporation, owns all of the stock of S, a controlled foreign corporation that uses x as its functional currency. In 1993, S earns 100x of passive foreign personal holding company income. When included in P's income under subpart F, the exchange rate is 1x equals $1. Therefore, P's subpart F inclusion is $100. At the end of 1993, S has previously taxed earnings and profits of 100x and P's basis in those earnings is $100. In 1994, S has no earnings and distributes 100x to P. The value of the earnings when distributed is $150. Assume that under section 986(c), P must recognize $50 of passive income attributable to the appreciation of the previously taxed income. Country X does not recognize any gain or loss on the distribution. Therefore, the section 986(c) gain is not subject to any foreign withholding tax or other foreign tax. Thus, under paragraph (c)(3)(iii) of this section, the section 986(c) gain shall be grouped with other items of P's income that are subject to no withholding tax or other foreign tax.

(iv) *Certain passive dividends.* A dividend from a controlled foreign corporation that is treated as passive income under the look-through rules shall be grouped according to the rules of paragraph (c)(4) of this section.

(6) * * *

(ii) *Exception.* Paragraph (c)(6)(i) of this section shall not apply to an increase in tax in a case in which the taxpayer is required to adjust its foreign taxes in the year of inclusion under section 905(c).

* * * * *

(7) * * *

(ii) * * * Thus, for purposes of determining to which year's taxes the reduction in taxes relates, foreign law shall apply. If, however, foreign law does not attribute a reduction in taxes to a particular year or years, then the reduction in taxes shall be attributable, on an annual last in-first out (LIFO) basis, to foreign taxes potentially subject to reduction that are associated with previously taxed income, then on a LIFO basis to foreign taxes associated with income that under paragraph (c)(7)(iii) of this section remains as passive income but that was excluded from subpart F income under section 954(b)(4), and finally on a LIFO basis to foreign taxes associated with other earnings and profits. * * *

(iii) * * * For an example illustrating the operation of this paragraph (c)(7)(iii), see paragraph (c)(8) *Example (7)* of this section.

(8) *Examples.* * * *

* * * * *

Example (4). Domestic corporation M operates in branch form in foreign countries X and Y. The branches are qualified business units (QBUs), within the meaning of section 989(a). In 1988, QBU X earns passive royalty income, interest income and rental income. All of the QBU X passive income is from Country Z sources. The royalty income is not subject to a withholding tax, and is not taxed by Country X, and the interest and the rental income are subject to a 5 percent and 10 percent withholding tax, respectively. QBU Y earns interest income in Country Y that is not subject to foreign tax. For purposes of determining whether M's foreign source passive income is high-taxed income, the rental income and the interest income earned in QBU X are treated as one item of income pursuant to paragraphs (c)(4)(ii) and (3)(ii) of this section. The interest income earned in QBU Y and the royalty income earned in QBU X are each treated as a separate item of income under paragraphs (c)(4)(i) (with respect to QBU Y's interest income) and (c)(4)(ii) and (3)(iii) (with respect to QBU X's royalty income) of this section.

* * * * *

Example (10). P, a domestic corporation, earns $100 of passive royalty income from sources within the United States. Under the laws of Country X, however, that royalty is considered to be from sources within Country X and Country X imposes a 10 percent withholding tax on the payment of the royalty. P also earns $100 of passive foreign source dividend income subject to a 10 percent withholding tax to which $15 of expenses are allocated. In determining whether P's passive income is high-taxed, the $10 withholding tax on P's royalty income is allocated to passive income, and within the passive category to the group of income described in paragraph (c)(3)(ii) of this section (passive income subject to a withholding tax of less than 15 percent (but greater than zero)). For purposes of determining whether the income is high-taxed, however, only the foreign source dividend income is taken into account. The foreign source dividend income will still be treated as passive income because the foreign taxes paid on the passive income in the group ($20) do not exceed the highest United States tax rate multiplied by the $85 of net foreign source income in the group ($20 is less than $28.90 ($100−$15) × .34).

* * * * *

(e) *Financial services income*—(1) *In general.* The term "financial services income" means income derived by a financial services entity, as defined in paragraph (e)(3) of this section, that is:

(i) Income derived in the active conduct of a banking, insurance, financing, or similar business (active financing income as defined in paragraph (e)(2) of this section), except income described in paragraph (e)(2)(i)(W) of this section (high withholding tax interest);

(ii) Passive income as defined in section 904(d) (2) (A) and paragraph (b) of this section as determined before the application of the exception for high-taxed income;

(iii) Export financing interest as defined in section 904(d)(2)(G) and paragraph (h) of this section that, but for section 904(d)(2)(B)(ii), would also meet the definition of high withholding tax interest; or

(iv) Incidental income as defined in paragraph (e)(4) of this section.

(2) * * *

(i) * * *

(V) Income from a finance lease. For this purpose, a finance lease is any lease that is a direct financing lease or a leveraged lease for accounting purposes and is also a lease for tax purposes.

* * * * *

(3) * * * (i) * * * For purposes of this paragraph, related person is defined in § 1.904–5(i)(1).

* * * * *

(iv) *Examples.* * * *

Example (1). P is a domestic corporation that owns 100 percent of the stock of S, a controlled foreign corporation incorporated in Country X. For the 1990 taxable year, 60 percent of S's income is active financing income that consists of income that will be considered general limitation or passive income if S is not a financial services entity. The other 40 percent of S's income is passive non-active financing income. S is not a financial services entity and its active financing income thus retains its character as general limitation and passive income. S makes an interest payment to P in 1990 that is characterized under the look-through rules. Although the interest is not financial services income to S under the look-through rules, it retains its character as active financing income when paid to P and P must take that income into account in determining whether it is a financial services entity under paragraph (e)(3)(i) of this section. If P is determined to be a financial services entity, both the portion of the interest payment characterized as active financing income

(whether general limitation or passive income in S's hands) and the portion characterized as passive non-active financing income received from S will be recharacterized as financial services income.

Example (2). [Reserved]

* * * * *

Example (5). P is a United States corporation that is not a financial services entity. P owns 100 percent of the stock of S, a controlled foreign corporation that is not a financial services entity. S owns 100 percent of the stock of T, a controlled foreign corporation that is a financial services entity. In 1991, T pays a dividend to S. The dividend from T is characterized under the look-through rules of section 904(d)(3). Pursuant to paragraph (e)(3)(i) of this section, the dividend from T is excluded in determining whether S is a financial services entity. S is determined not to be a financial services entity but the dividend retains its character as financial services income in S's hands. Any subpart F inclusion or dividend to P out of earnings and profits attributable to the dividend from T will be excluded in determining whether P is a financial services entity but the inclusion or dividend will retain its character as financial services income.

* * * * *

(5) * * *

(i) Export financing interest as defined in section 904(d)(2)(G) and paragraph (h) of this section unless that income would be high withholding tax interest as defined in section 904(d)(2)(B) but for paragraph (d)(2)(B)(ii) of that section;

(ii) High withholding tax interest as defined in section 904(d)(2)(B) unless that income also meets the definition of export financing interest; and

* * * * *

(f) * * * Shipping income does not include any dividends received or accrued from a noncontrolled section 902 corporation, any income that is financial services income, or any income described in section 904(d)(1)(G) (foreign trade income within the meaning of section 923(b)).

(g) * * *

(2) * * *

(iv) *Treatment of inclusions under section 1293.* If a foreign corporation is a noncontrolled section 902 corporation with respect to a taxpayer, any inclusion in the taxpayer's gross income under section 1293 with respect to that corporation shall be treated as a dividend from a noncontrolled section 902 corporation and thus shall be subject to a separate limitation.

(3) * * *

(ii) *Dividend distributions out of earnings and profits for a year during which a shareholder that is currently a more-than-90-percent United States shareholder was not a United States shareholder.* [Reserved]

(iii) *Ordering rule.* [Reserved]

(iv) *Examples.* [Reserved]

* * * * *

(h) * * *

(2) *Treatment of export financing interest.* Except as provided in paragraph (h)(3) of this section, if a taxpayer (including a financial services entity) receives or accrues export financing interest from an unrelated person, then that interest shall be treated as general limitation income.

(3) *Exceptions—(i) Export financing interest that is high withholding tax interest.* If a financial services entity receives or accrues export financing interest that would also be high withholding tax interest but for section 904(d)(2)(B)(ii), that income shall be treated as financial services income.

(ii) *Export financing interest that is also related person factoring income.* Export financing interest shall be treated as passive income if that income is also related person factoring income. For this purpose, related person factoring income is—

(A) Income received or accrued by a controlled foreign corporation that is income described in section 864(d)(6) (income of a controlled foreign corporation from a loan for the purpose of financing the purchase of inventory property of a related person); or

(B) Income received or accrued by any person that is income described in section 864(d)(1) (income from a trade receivable acquired from a related person).

(iii) *Export financing interest that is related person factoring income and is received or accrued by a financial services entity.* If a financial services entity receives or accrues export financing interest that is also related person factoring income, then the income shall be treated as financial services income. See section 864(d)(5)(A)(i).

(iv) *Export financing interest that is related person factoring income and high withholding tax interest.* If any taxpayer (including a financial services entity) receives or accrues export financing interest that is also related person factoring income and high withholding tax interest, then that income shall be treated as high withholding tax interest. See section 864(d)(5)(A)(i).

(4) *Examples.* The following examples illustrate the operation of paragraph (h)(3) of this section:

* * * * *

Example (2). The facts are the same as in *Example (1)* except that S is a financial services entity and derives the income in an active financing business. The income derived by S on the receivables is related person factoring income and is also export financing interest. Therefore, pursuant to paragraph (h)(3)(iii) of this section, the income is financial services income to S.

* * * * *

(5) *Income eligible for section 864(d)(7) exception (same country exception) from related person factoring treatment*—(i) *Income other than interest.* * * * If a financial services entity receives or accrues that income, the income shall not be considered to be export financing interest and, therefore, shall be treated as financial services income.

(ii) *Interest income.* * * * If that interest is received or accrued by a financial services entity, section 904(d)(2)(C)(iii)(III) shall apply and the interest shall be treated as general limitation income. If that interest also would be high withholding tax interest but for section 904(d)(2)(B)(ii), then the interest shall be treated as financial services income.

(iii) *Examples.* The following examples illustrate the operation of this paragraph (h) (5):

Example (1). Controlled foreign corporation S is a wholly-owned subsidiary of domestic corporation P. Controlled foreign corporation T is a wholly-owned subsidiary of controlled foreign corporation S. S and T are incorporated in Country M. In 1987, P sells tractors to T, which T sells to X, an unrelated foreign corporation organized in country M. The tractors are to be used in country M. T uses a substantial part of its assets in its trade or business located in Country M. T has uncollected trade receivables from X that it factors to S. S derived more than 20 percent of its gross income for 1987 other than from an active financing business and the income derived by S from the receivables is not derived in an active financing business. Thus, pursuant to paragraph (e)(3)(i) of this section, S is not a financial services entity. The income is not related person factoring income because it is described in section 864(d)(7) (income eligible for the same country exception). If section 864(d)(1) applied, the income S derived from the receivables would meet the definition of export financing interest. The income, therefore, is considered to be export financing interest and is general limitation income to S.

Example (2). The facts are the same as in *Example (1)*except that S is a financial services entity and derives the income on the receivables from the conduct of an active financing business. The income S derives from the receivables is not related person factoring income because it is described in section 864(d)(7). If the income would be high withholding tax interest but for section 904(d)(2)(B)(ii), then the income will not be considered to be export financing interest and will be financial services income to S. Otherwise, the income will be considered to

be export financing interest and will be general limitation income to S.

* * * * *

Example (4). The facts are the same as in *Example (3)* except that S is a financial services entity and derives the interest on the loan to X in an active financing business. The interest S earns is export financing interest that is not described in section 864(d)(1) because it is described in section 864(d)(7). Because the interest is described in section 864 (d)(7) and is export financing interest, section 904(d)(2)(C)(iii)(III) shall apply and the income shall be general limitation income to S, unless it would also be high withholding tax interest but for section 904(d)(2)(B)(ii), in which case it will be financial services income to S.

* * * * *

(k) *Special rule for alternative minimum tax foreign tax credit.* For purposes of computing the alternative minimum tax foreign tax credit under section 59(a), items included in alternative minimum taxable income by reason of section 56(g) (adjustments based on adjusted current earnings) shall be characterized as income described in a separate category under section 904(d) and this section based on the character of the underlying items of income.

(l) *Priority rules*—(1) *In general.* In the case of income that meets the definitions of more than one category of separate limitation income, the following priority rules apply:

(i) Income that meets the definitions of passive income and of any other separate limitation income described in section 904(d)(1) (B) through (H) will be subject to the other separate limitation;

(ii) Income that meets the definitions of financial services income and of either shipping income or passive income will be subject to the separate limitation for financial services income;

(iii) Income that meets the definitions of financial services income and of any separate limitation income other than shipping or passive income will be subject to the other separate limitation;

(iv) Income that meets the definitions of dividends from a noncontrolled section 902 corporation and of any other separate limitation income will be subject to the separate limitation for dividends from a noncontrolled section 902 corporation unless that income is foreign oil and gas extraction income defined in section 907(c), in which case it will be treated as general limitation income pursuant to § 1.907(a)–1(f);

(v) Income that meets the definitions of high withholding tax interest and of any other separate limitation income will be high withholding tax interest; and

(vi) Income that meets the definitions of shipping income and of foreign trade income will be subject to the separate limitation for foreign trade income.

(2) *Examples.* The provisions of this paragraph (l) are illustrated by the following examples:

Example (1). Controlled foreign corporation S is a wholly-owned subsidiary of domestic corporation P. S owns 20 percent of the voting stock of T, a foreign corporation that is not a controlled foreign corporation. In 1987, T pays S a dividend that qualifies as foreign base company shipping income to S under § 1.954–6(f)(1). The dividend from T is also a dividend from a noncontrolled section 902 corporation. Therefore, pursuant to section 904(d)(2)(D) and paragraph (l)(1)(iv) of this section, the dividend from T is treated as a dividend from a noncontrolled section 902 corporation.

Example (2). In 1987, domestic corporation P received a dividend from R, a foreign corporation that is not a controlled foreign corporation. P owns 30 percent of the voting stock of R. P is a financial services entity and the dividend from R qualifies as financial services income under paragraph (e)(4)(i)(A) of this section. The dividend from R is also a dividend from a noncontrolled section 902 corporation. Therefore, pursuant to section 904(d)(2)(C) (iii)(II) and paragraphs (l)(1)(iii) and (iv) of this section, the dividend from R is treated as a dividend from a noncontrolled section 902 corporation.

Example (3). P, a domestic corporation, owns 10 percent of foreign corporation S. S is a noncontrolled section 902 corporation. In 1990, S earns foreign oil and gas extraction income which is general limitation income. S pays a dividend to P out of its earnings and profits for 1990. The dividend from S is a dividend from a noncontrolled section 902 corporation that is also foreign oil and gas extraction income. Pursuant to section 907(c)(3)(A), § 1.907(a)–1(f) and paragraph (l)(1)(iv) of this section, P will include the dividend in income as general limitation income.

Par. 4. Section 1.904–5 is amended as follows:

1. Paragraph (a) is amended by:

a. Removing the language "this section" in the introductory text and adding in its place "the regulations under section 904"; and

b. Removing the language "section 1504(a)(2)" the first time it appears in the last sentence of paragraph (a) (3) and adding in its place "section 1504(a)(1)".

2. Paragraph (b) is amended by removing the language "section 904(d)(3)" and adding in its place "section 904(d) (2)(E) and (3)".

3. Paragraph (c)(1)(i) is amended by removing the last sentence and adding two new sentences in its place.

4. In paragraph (c)(1)(ii), text is added to *Example (2)* and *Example (3)*, *Example (4)* is redesignated as *Example (5)*, and a new *Example (4)* is added.

5. Paragraph (c)(2)(i) is revised.

6. Paragraph (c)(2)(ii) is amended by:

a. Revising the heading;

b. Revising the introductory text;

c. Revising paragraph (c)(2)(ii)(B);

d. Revising paragraphs (c)(2)(ii) (D) and (E).

7. Paragraph (c)(2)(iii)(A) is amended by removing "§ 1.861–8" in the first sentence and adding in its place "§ 1.861–9T(g)"; by removing "§ 1.861–8" in the second sentence and adding in its place "§ 1.861–10T(d)(2)"; and by removing "§ 1.861–8" in the last sentence and adding in its place "§ 1.861–9T(g)(2)".

8. Paragraph (c)(2)(iv) *Example (1)* is amended by:

a. Removing the language "allocate" in the last sentence of *Example (1)* (i) and adding "apportion" in its place; and

b. Removing the language "allocable" in the third sentence of *Example (1)* (ii) and adding "apportioned" in its place, and removing the language "allocated" in the fifth and sixth sentences and adding "apportioned" in its place.

9. Paragraph (c)(2)(iv) *Example (2)* is amended by removing the language "for allocating" in the first sentence and adding "to apportion" in its place, and by removing the language "allocated" each place it appears in the second and third sentences and adding "apportioned" in its place.

10. Paragraph (c)(2)(iv) *Example (3)* is amended by:

a. Removing the language "allocated" in the last sentence of *Example (3)* (i) and adding "apportioned" in its place; and

b. Revising *Example (3)* (iii) and (iv).

11. Paragraph (c)(2)(iv) *Example (4)* is amended by:

a. Removing in *Example (4)* (i) the language "§ 1.861–8" and adding in its place "§§ 1.861–8 through 1.861–14T", and removing the language "allocate" in the last two sentences and adding in its place "apportion";

b. Removing in *Example (4)* (ii) the language "(c)(2)(ii) (B)" and adding "(c)(2)(ii) (C)", and by removing the language "allocated" in the second sentence and adding "apportioned" in its place; and

c. Removing in *Example (4)* (iii) the language "allocated" each place it appears and adding "apportioned" in its place and by removing the language "allocable" in the last sentence and adding "apportioned" in its place.

12. Paragraph (c)(2)(iv) *Example (5)* is amended by removing the language "allocate" in the first sentence and adding "apportion" in its place, and by removing the language "allocated" in the third and fourth sentences and adding "apportioned" in its place.

13. Paragraph (c)(3) is amended by removing "§ 1.861–8" and adding in its place "§§ 1.861–8 through 1.861–14T".

14. Paragraph (c)(4)(ii) is amended by removing the reference "paragraph (i) of this section" in the first sentence and adding in its place "§ 1.904–5(i)".

15. Paragraph (c)(4)(iii) *Example (1)* is revised.

16. Paragraph (d) is amended by:

a. Revising paragraph (d)(1);

b. Removing in paragraph (d)(2) the reference "§ 1.904–4(k)" and adding "§ 1.904–4(l)"; and

c. In paragraph (d)(3), adding text to *Example (1)* and *Example (2)*.

17. Paragraph (e)(1) is amended by inserting "or gross insurance income (whichever is appropriate)" in the first sentence after "foreign base company income" the second time it appears.

18. Paragraph (f)(1) is amended by adding after the first sentence "See section 904(d)(3)(H).".

19. Paragraph (f)(2) is amended by designating the text after the heading as paragraph (f)(2)(i); by adding a heading to newly designated paragraph (f)(2)(i); and adding a new paragraph (f)(2)(ii).

20. Paragraph (f)(3) is revised.

21. Paragraph (g) is revised.

22. Paragraph (h)(3) is revised.

23. Paragraph (i)(1) is amended by removing the first sentence and adding a new sentence in its place.

24. Paragraph (i)(3), the heading is revised and the paragraph is reserved.

25. Paragraph (i)(4) is added.

26. Paragraph (j) is revised.

27. Paragraph (k)(1) is revised.

28. Paragraph (l) is amended by:

a. Adding in *Example (1)*, in the eighth sentence, after the word "because" the language "S and T are related look-through entities within the meaning of paragraph (i)(1) of this section and, therefore";

b. Adding text to *Example (2)* and *Example (5)*;

c. Amending *Example (8)*(i), in the second sentence, by adding the word "company" after the word "holding";

d. Amending *Example (10)*(iii), in the second sentence, by removing the language "(g)" and adding in its place "(c)(1)(i)"; and

e. Adding *Example (11)*.

29. Paragraph (m)(2) is amended by removing the last two sentences and adding two new sentences in their place.

30. Paragraph (m)(3) *Example (4)*, the third paragraph, is amended by removing "$16" each place it appears and adding "$19" in its place.

31. Paragraph (m)(7) is revised.

32. The revised, reserved and added provisions read as follows:

§ 1.904–5 Look-through rules as applied to controlled foreign corporations and other entities.

* * * * *

(c) * * * (1) * * * (i) * * * For purposes of this § 1.904–5, income shall be characterized under the rules of § 1.904–4 prior to the application of the rules of paragraph (c) of this section. For rules concerning inclusions under section 951(a)(1)(B), see paragraph (c)(4)(i) of this section.

(ii) * * *

Example (2). Controlled foreign corporation S is a wholly-owned subsidiary of domestic corporation P. S is a financial services entity. P manufactures cars and is not a financial services entity. In 1987, S earns $200 of interest income unrelated to its banking business and $900 of interest income related to its banking business. Assume that S pays no foreign taxes and has no expenses. All of S's income is included in P's gross income as foreign personal holding company income. Because S is a financial services entity, income that would otherwise be passive income is considered to be financial services income. P, therefore, treats the entire subpart F inclusion as financial services income.

Example (3). Controlled foreign corporation S is a wholly-owned subsidiary of domestic corporation P. P is a financial services entity. S manufactures cars and is not a financial services entity. In 1987, S earns $200 of passive income that is subpart F income and $900 of general limitation non-subpart F income. Assume that S pays no foreign taxes on its passive earnings and has no expenses. P includes the $200 of subpart F income in gross income. Because P is a financial services entity, the inclusion will be financial services income to P.

Example (4). Controlled foreign corporation S is a wholly-owned subsidiary of domestic corporation P. Neither P nor S is a financial services entity. Controlled foreign corporation T is a wholly-owned subsidiary of controlled foreign corporation S. T is a financial services entity. In 1991, T pays a dividend to S. For purposes of determining whether S is a financial services entity under § 1.904–4(e)(3)(i), the dividend from T is ignored. For purposes of characterizing the dividend in S's hands under the look-through rules of paragraph (c)(4) of this section, however, the dividend retains its character as financial services income. Similarly, any subpart F inclusion or dividend to P out of the earnings and profits attributable to the dividend from S is excluded in determining whether P is a financial services entity under § 1.904–4(e)(3)(i), but retains its character in P's hands as financial services income under paragraph (c)(4) of this section.

* * * * *

(2) *Interest*—(i) *In general.* For purposes of this paragraph, related person interest is any interest paid or accrued by a controlled foreign corporation to any United States shareholder in that corporation (or to any other related person) to which the look-through rules of section 904(d)(3) and this section apply. Unrelated person interest is all interest other than related person interest. Related person interest shall be treated as income in a separate category to the extent it is allocable to income of the controlled foreign corporation in that category. If related person interest is received or accrued from a controlled foreign corporation by two or more persons, the amount of interest received or accrued by each person that is allocable to any separate category of income shall be determined by multiplying the amount of related person interest allocable to that separate category of income by a fraction. The numerator of the fraction is the amount of related person interest received or accrued by that person and the denominator is the total amount of related person interest paid or accrued by the controlled foreign corporation.

(ii) *Allocating and apportioning expenses including interest paid to a related person.* Related person interest and other expenses of a controlled foreign corporation shall be allocated and apportioned in the following manner:

* * * * *

(B) Any expenses that are definitely related to less than all of gross income as a class, including unrelated person interest that is directly allocated to income from a specific property, shall be allocated and apportioned under the principles of §§ 1.861–8 or 1.861-10T, as applicable, to income in each separate category;

* * * * *

(D) To the extent that related person interest exceeds passive foreign personal holding company income as determined after the application of paragraphs (c)(2)(ii) (B) and (C) of this section, the related person interest shall be apportioned under the rules of this paragraph to separate categories other than passive income.

(*1*) If under § 1.861–9T, the modified gross income method of apportioning interest expense is elected, related person interest shall be apportioned as follows:

$$\text{Related person interest} - \text{Related person interest allocated under paragraph (c)(2)(ii)(C) of this section} \times \frac{\text{Gross income in a separate category (other than passive)}}{\text{Total gross income (other than passive)}}$$

(*2*) If under § 1.861–9T, the asset method of apportioning interest expense is elected, related person interest shall

be apportioned according to the following formula:

$$\text{Related person interest minus Related person interest minus allocated under paragraph (c)(2)(ii)(C) of this section} \times \frac{\text{Value of assets in a separate category (other than passive)}}{\text{Value of total assets (other than passive)}}$$

(E) Any other expenses (including unrelated person interest that is not directly allocated to income from a specific property) that are not definitely related expenses or that are definitely related to all of gross income as a class shall be apportioned under the rules of this paragraph to reduce income in each separate category.

(*1*) If under § 1.861–9T, the modified gross income method of apportioning interest expense is elected, the interest expense shall be apportioned as follows:

$$\text{Expense apportionable to a separate category} = \text{Expense} \times \frac{\text{Gross income in a separate category (minus related person interest allocated under paragraph (c)(2)(ii)(C) of this section if the category is passive)}}{\text{Total gross income minus related person interest allocated to passive income under paragraph (c)(2)(ii)(C) of this section}}$$

(*2*) If under § 1.861–9T, the asset method of apportioning interest expense is elected, then the expense shall be apportioned as follows:

$$\text{Expense apportionable to a separate category} = \text{Expense} \times \frac{\text{Value of assets in a separate category (minus related person debt allocated to passive assets if the category is passive)}}{\text{Value of total assets minus related person debt allocated to passive assets}}$$

(*3*) Expenses other than interest shall be apportioned in a similar manner depending on the apportionment method used. *See* § 1.861–8T(c)(1) (i)–(vi).

* * * * *

(iv) * * *

Example (3). * * *

(iii) Under paragraph (c)(2)(ii)(E) of this section, the non-interest expenses that are not definitely related are apportioned on the basis of the asset values reduced by the allocated related person debt. Therefore, $10 of these expenses are apportioned to the passive category ($50×($2000−$1500)/($4000−$1500)) and $40 are apportioned to the general limitation category ($50×$2000/($4000−$1500)).

(iv) In order to apportion third person interest between the categories of assets, the value of assets in a separate category must also be reduced under the principles of § 1.861–8 by the indebtedness relating to the specifically allocated interest. Therefore, under paragraph (c)(2)(iii)(B) of this section, the value of assets in the passive category for purposes of apportioning the additional third person interest=0 ($2000 minus $500 (the principal amount of the debt, the interest payment on which is directly allocated to specific interest producing properties) minus $1500 (the related person debt allocated to passive assets)). Under paragraph (c)(2)(ii)(E) of this section, all $100 of the non-definitely related third person interest is apportioned to the general limitation category ($100=$100×$2000/($4000−$500−$1500)).

* * * * *

(4) * * *

(iii) * * *

Example (1). Controlled foreign corporation S is a wholly-owned subsidiary of P, a domestic corporation. In 1987, S has earnings and profits of $1,000, $600 of which is attributable to general limitation income and $400 of which is attributable to dividends received by S from its wholly-owned subsidiary, T. T is a controlled foreign corporation and is incorporated and operates in the same country as S. All of T's income is financial services income. Neither S's general limitation income nor the dividend from T is subpart F income. In December 1987, S pays a dividend to P of $200, all of which is attributable to earnings and profits earned in 1987. Six-tenths of the dividend ($120) is treated as general limitation income because six-tenths of S's earnings and profits are attributable to general limitation income. Four-tenths of the dividend ($80) is treated as financial services income because four-tenths of S's earnings and profits are attributable to dividends from T, and all of T's earnings are financial services income.

* * * * *

(d) *Effect of exclusions from subpart F income*—(1) *De minimis amount of subpart F income.* If the sum of a controlled foreign corporation's gross foreign base company income (determined under section 954(a) without regard to section 954(b)(5)) and gross insurance income (determined under section 953(a)) for the taxable year is less than the lesser of 5 percent of gross income or $1,000,000, then all of that income (other than income that would be financial services income without regard to this paragraph (d)(1)) shall be treated as general limitation income. In addition, if the test in the preceding sentence is satisfied, for purposes of paragraphs (c)(2)(ii) (D) and (E) of this section (apportionment of interest expense to passive income using the asset method), any passive limitation assets shall be treated as general limitation assets. The determination in the first sentence shall be made prior to the application of the exception for certain income subject to a high rate of foreign tax described in paragraph (d)(2) of this section.

* * * * *

(3) * * *

Example (1). Controlled foreign corporation S is a wholly-owned subsidiary of P, a domestic corporation. In 1987, S earns $100 of gross income, $4 of which is interest that is subpart F foreign personal holding company income and $96 of which is gross manufacturing income that is not subpart F income. S has no other earnings for 1987. S has no expenses and pays no foreign taxes. S pays P a $100 dividend. Under the de minimis rule of section 954(b)(3), none of S's income is treated as foreign base company income. All of S's income, therefore, is treated as general limitation income. The entire $100 dividend is general limitation income to P.

Example (2). (i) Controlled foreign corporation S is a wholly-owned subsidiary of P, a domestic corporation. In 1987, S earns $50 of shipping income of a type that is foreign base company shipping income. S also earns $50 of dividends from T, a foreign corporation in which S owns 45 percent of the voting stock, and receives $50 of dividends from U, a foreign corporation in which S owns 5% of the voting stock. Foreign persons hold the remaining voting stock of both T and U. S, T, and U are all incorporated in different foreign countries. The dividends S receives from T and U are of a type that normally would be subpart F foreign personal holding company income that is passive income. Under § 1.904–4(l)(1)(iv), however, the dividends from T are dividends from a noncontrolled section 902 corporation rather than passive income. S has no expenses. The earnings and profits of S are equal to the net income after taxes of S. The dividends and the shipping income are taxed abroad by S's country of incorporation at an effective rate of 40 percent. P establishes to the satisfaction of the Secretary that the effective rate of tax on both the dividends and the shipping income exceeds 90 percent of the maximum United States tax rate. Thus, under section 954(b)(4), neither the shipping income nor the dividends are taxed currently to P under subpart F. S's earnings attributable to shipping income and dividends from a noncontrolled section 902 corporation retain their character as such. Under paragraph (d)(2) of this section, S's earnings attributable to the dividends from U are treated as earnings attributable to general limitation income. See §§ 1.905–3T and 1.905–4T, however, for rules concerning adjustments to the pools of earnings and profits and foreign taxes and redeterminations of United States tax liability when foreign taxes are refunded in a later year.

(ii) In 1988, S has no earnings and pays a $150 dividend (including gross-up) to P. The dividend is paid out of S's post-1986 pool of earnings and profits. One-third of the dividend ($50) is attributable to S's shipping earnings, one-third ($50) is attributable to the dividend from T, and one-third ($50) is

attributable to the dividend from U. Pursuant to section 904(d)(3)(E) and paragraph (c)(4) of this section, one-third of the dividend is shipping income, one-third is a dividend from a noncontrolled section 902 corporation, T, and one-third is general limitation income to P.

* * * * *

(f) * * *

(2) * * *—(i) *Rule.* * * *

(ii) *Example.* The following example illustrates the provisions of this paragraph (f)(2).

Example. P, a domestic corporation, owns 40 percent of S, a controlled foreign corporation. U, an unrelated domestic corporation, owns the remaining 60 percent of S. S owns 10 percent of T, a noncontrolled section 902 corporation. In 1990, T pays S a dividend, which S includes in its gross income as a dividend from a noncontrolled section 902 corporation. S has no other income during 1990. P and U must include S's dividend income from T in their gross income under subpart F. Pursuant to § 1.904–4(g)(2)(ii)(C), the subpart F inclusion to U is characterized as a dividend from a noncontrolled section 902 corporation because U meets the 5 percent ownership requirement of section 902(b) (60%×10%=6%). The subpart F inclusion to P is characterized as passive income because P does not meet the 5 percent ownership requirement of section 902(b) (40%×10%=4%).

(3) *Distributions from a FSC.* Income received or accrued by a taxpayer that, under the rules of paragraph (c)(4) of this section (look-through rules for dividends), would be treated as foreign trade income or as passive income that is interest and carrying charges (as defined in section 927(d)(1)), and that is also a distribution from a FSC (or a former FSC), shall be treated as a distribution from a FSC (or a former FSC).

* * * * *

(g) *Application of look-through rules to certain domestic corporations.* The principles of section 904(d)(3) and this section shall apply to any foreign source interest, rents and royalties paid by a United States corporation to a related corporation. For this purpose, a United States corporation and another corporation are considered to be related if one owns, directly or indirectly, stock possessing 50 percent or more of the total voting power of all classes of stock of the other corporation or 50 percent or more of the total value of the other corporation. In addition, a United States corporation and another corporation shall be considered to be related if the same United States shareholders own, directly or indirectly, stock possessing 50 percent or more of the total voting power of all classes of stock or 50 percent of the total value of each corporation. For purposes of this paragraph, the constructive stock ownership rules of section 318 and the regulations under that section apply.

(h) * * *

(3) *Income from the sale of a partnership interest.*

To the extent a partner recognizes gain on the sale of a partnership interest, that income shall be treated as passive income to the partner, unless the income is considered to be high-taxed under section 904(d)(2)(A)(iii)(III) and § 1.904–4(c).

* * * * *

(i) * * * (1) * * * Except as provided in paragraphs (i) (2) and (3) of this section, the principles of this section shall apply to distributions and payments that are subject to the look-through rules of section 904(d)(3) and this section from a controlled foreign corporation or other entity otherwise entitled to look-through treatment (a "look-through entity") under this section to a related 1ookthrough entity. * * *

* * * * *

(3) *Special rule for dividends.* [Reserved]

(4) *Examples.* The following examples illustrate the provisions of this paragraph (i):

Example (1). P, a domestic corporation, owns all of the stock of S, a controlled foreign corporation. S owns 40 percent of the stock of T, a controlled foreign corporation. The remaining 60 percent of the stock of T is owned by V, a domestic corporation. The percentages of value of T owned by S and V correspond to their percentages of stock ownership. T owns all of the stock of U, a controlled foreign corporation. U earns exclusively general limitation non-subpart F income. In 1992, U makes an interest payment of $100 to T, which is subpart F income to P and V. V and T are related look-through entities, but P and T are not related look-through entities. V, therefore, is entitled to look-through treatment on the interest payment to T and the payment will be treated as general limitation income. P is not entitled to look-through treatment (because P, through 5, owns only 40 percent of T) and the interest payment, therefore, is passive income to P.

Example (2). [Reserved]

(j) *Look-through rules applied to passive foreign investment company inclusions.* If a passive foreign investment company is a controlled foreign corporation and the taxpayer is a United States shareholder in that passive foreign investment company, any amount included in gross income under section 1293 shall be treated as income in a separate category to the extent the amount so included is attributable to income received or accrued by that controlled foreign corporation that is described as income in the separate category. For purposes of this paragraph (j), the priority rules of § 1.904–4(l) shall apply prior to the application of the rules of this paragraph.

(k) * * * (1) *In general.* Income received or accrued by a related person to which the look-through rules apply is characterized before amounts included from, or paid or distributed by that person and received or accrued by a related person. For purposes of determining the character of income received or accrued by a person from a related person if the payor or another related person also receives or accrues income from the recipient and the look-through rules apply to the income in all cases, the rules of paragraph (k)(2) of this section apply.

* * * * *

(1) * * *

Example (2). The facts are the same as in *Example (1)* except that instead of earning $100 of general limitation foreign base company sales income, S earns $100 of foreign personal holding company income that is passive income. Although the interest payment to T would otherwise be passive income, T is a financial services entity and, under § 1.904–4(e)(1), the income is treated as financial services income in T's hands. Thus, P's entire $350 section 951 inclusion consists of financial services income.

* * * * *

Example (5). P has a 25 percent interest in partnership PS that he sells to X for $110. P's basis in his partnership interest is $35. P recognizes $75 of gain on the sale of its partnership interest and is subject to no foreign tax. Under paragraph (h)(3) of this section, the gain is treated as passive income.

* * * * *

Example (11). P, a domestic corporation, owns 100 percent of the stock of S, a controlled foreign corporation, and S owns 100 percent of the stock of T, a controlled foreign corporation. P also owns 100 percent of the stock of U, a controlled foreign corporation. In 1991, T earns $100 of general limitation income that is not subpart F income and distributes the entire amount to S as a dividend. S earns $100 of passive foreign personal holding company income and the $100 dividend from T. S pays $100 of interest to U. U earns $200 of general limitation income that is foreign base company income and $100 of interest income from S. This transaction does not involve circular payments and, therefore, the ordering rules of paragraph (k)(2) of this section do not apply. Instead, pursuant to paragraph (k)(1) of this section, income received is characterized first. T's earnings and, thus, the dividend from T to S are characterized first. S includes the $100 dividend from T in gross income as general limitation income because all of T's earnings are general limitation income. S thus has $100 of passive foreign personal holding company income and $100 of general limitation income. The interest payment to U is then characterized as $100 passive income under paragraph (c)(2)(ii)(C) of this section

(allocation of related person interest to passive foreign personal holding company income). For 1991, U thus has $200 of general limitation income that is subpart F income, and $100 of passive foreign personal holding company income. For 1991, P includes in its gross income $200 of general limitation subpart F income from U, $100 of passive subpart F income from U (relating to the interest payment from S to U), and $100 of general limitation subpart F income from S (relating to the dividend from T to S).

(m) * * *

(2) * * *

For purposes of this paragraph, the value of assets in a separate category is the value of assets as determined under the principles of § 1.861–9T(g). See § 1.861–10T(d)(2) for purposes of determining the value of assets and gross income in a separate category as reduced for indebtedness the interest on which is directly allocated.

* * * * *

(7) *Coordination with treaties*—(i) *Rule.* If any amount of income derived from a United States-owned foreign corporation, as defined in section 904(g)(6), would be treated as derived from sources within the United States under section 904(g) and this paragraph (m) and, pursuant to an income tax convention with the United States, the taxpayer chooses to avail itself of benefits of the convention that treat that amount as arising from sources outside the United States under a rule explicitly treating the income as foreign source, then that amount will be treated as foreign source income. However, sections 904 (a), (b), (c), (d) and (f), 902, 907, and 960 shall be applied separately to amounts described in the preceding sentence with respect to each treaty under which the taxpayer has claimed benefits and, within each treaty, to each separate category of income.

(ii) *Example.* The following example illustrates the application of this paragraph (m)(7).

Example. Controlled foreign corporation S is incorporated in Country A and is a wholly-owned subsidiary of P, a domestic corporation. In 1990, S earns $80 of foreign base company sales income in Country A which is general limitation income and $40 of U.S. source interest income. S incurs $20 of expenses attributable to its sales business. S pays P $40 of interest that is allocated to U.S. source passive income under paragraphs (c)(2)(ii)(C) and (m)(2) of this section. Assume that earnings and profits equal net income. All of S's net income of $60 is includible in P's gross income under subpart F (section 951(a)(1)). For 1990, P also has $100 of passive income derived from investments in Country B. Pursuant to section 904(g)(3) and paragraph (m)(2) of this section, the $40 interest payment from S is United States source income to P because it is attributable to United States source interest income of S. The United States-Country A income tax treaty, however, treats all interest payments by residents of Country A as Country A sourced and P elects to apply the treaty. Pursuant to section 904(g)(10) and this paragraph (m)(7), the entire interest payment will be treated as foreign source income to P. P thus has $60 of foreign source general limitation income, $40 of foreign source passive income from S, and $100 of other foreign source passive income. In determining P's foreign tax credit limitation on passive income, the passive income from Country A shall be treated separately from any other passive income.

* * * * *

Par. 5. Section 1.904–6 is amended as follows:

1. The section heading for § 1.904–6 is revised.

2. The heading for paragraph (a) is revised.

3. Paragraph (a)(1)(ii) is amended by removing the reference "§ 1.861–8" in the three places it now appears and adding in its place "§§ 1.861–8 through 1.861–14T", and by adding the language "and apportioning" after "allocating" and before "such" in the seventh sentence.

4. Paragraph (a)(1)(iv) is added.

5. Paragraph (a)(2) is revised.

6. Paragraph (b)(1), in the last sentence, is amended by removing "of" after "foreign taxes deemed paid" and adding "by".

7. Paragraph (b)(2)(i) is revised.

8. Paragraph (c) is amended by:

a. Removing in *Example (1),* in the fourth sentence, the reference "§ 1.861–8" and adding in its place "§§ 1.861–8 through 1.861–14T";

b. Removing in *Example (1),* in the fifth sentence, the language "allocates" and adding "apportions" in its place;

c. Removing the last two sentences in *Example (5)* and adding two new sentences in their place;

d. Removing the language "$25" in the first parenthetical in *Example (6)* and adding "$50" in its place; and

e. Revising the introductory text of *Example (8).*

9. The added and revised provisions read as follows:

§ 1.904–6 Allocation and apportionment of taxes.

(a) *Allocation and apportionment of taxes to a separate category or categories of income*—(1) * * *

(iv) *Special rule for base and timing differences.* If, under the law of a foreign country or possession of the United States, a tax is imposed on an item of income that does not constitute income under United States tax principles, that tax shall be treated as imposed with respect to general limitation income. If, under the law of a foreign country or possession of the United States, a tax is imposed on an item that would be income under United States tax principles in another year, that tax will be allocated to the appropriate separate category or categories as if the income were recognized under United States tax principles in the year in which the tax was imposed.

(2) *Treatment of certain dividends from noncontrolled section 902 corporations.* If a taxpayer receives or accrues a dividend from a noncontrolled section 902 corporation, and if the Commissioner establishes that there is an agreement, express or implied, that such dividend is paid out of the passive earnings or high withholding tax interest income of the foreign corporation, then only the foreign taxes imposed on passive income or high withholding tax interest income of the noncontrolled section 902 corporation will be considered to be taxes related to the dividend. For an illustration of this rule, see paragraph (c) *Example (7)* of this section.

(b) * * *

(2) * * *

(i) Any portion of a distribution received from a first-tier corporation by a domestic corporation or individual that is excluded from the domestic corporation's or individual's income under section 959(a) and § 1.959–1; and

* * * * *

(c) * * *

Example (5). * * * For U.S. purposes, the income is not characterized as a dividend but as a repayment of a bona fide debt and, therefore, the $50 of income is not required to be recognized by R in 1988. The $10 of tax is treated as a tax paid in 1988 on the $50 of passive income included by R in 1987 pursuant to the section 482 adjustment rather than as a tax associated with a dividend from a noncontrolled section 902 corporation. The $10 tax is a tax imposed on passive income under paragraph (a)(1)(iv) of this section.

* * * * *

Example (8). Domestic corporation P owns all of the stock of controlled foreign corporation S, which owns all of the stock of controlled foreign corporation T. All such corporations use the calendar year as the taxable year. Assume that earnings and profits are equal to net income and that the income amounts are identical under United States and foreign law principles. In 1987, T earns (before foreign taxes) $187.50 of net passive income and $62.50 of net general limitation income and pays $50 of foreign taxes. S earns no income in 1987 and pays no foreign taxes. For 1987, P is required under section 951 to include in gross income $175 attributable to the earnings and profits of T for that year. One hundred and fifty dollars ($150) of the subpart F inclusion is attributable to passive income earned by T, and $25 of the subpart F inclusion is

attributable to general limitation income earned by T. In 1988, T earns no income and pays no foreign taxes. T pays a $200 dividend to S, consisting of $175 from its earnings and profits attributable to amounts required to be included in P's gross income with respect to T and $25 from its other earnings and profits. Assume that no withholding tax is imposed with respect to the distribution from T to S. In 1988, S earns $100 of net general limitation income and receives a $200 dividend from T. S pays $30 in foreign taxes. For 1988, P is required under section 951 to include in gross income $22.50 attributable to the earnings and profits of S for such year. The entire subpart F inclusion is attributable to general limitation income earned by S. In 1988, S pays P a dividend of $247.50, consisting of $157.50 from its earnings and profits attributable to the amount required under section 951 to be included in P's gross income with respect to T, $22.50 from its earnings and profits attributable to the amount required under section 951 to be included in P's gross income with respect to S, and $67.50 from its other earnings and profits. Assume the de minimis rule of section 954(b)(3)(A) and the full inclusion rule of section 954(b)(3)(B) do not apply to the gross amounts of income earned by S and T. The foreign income taxes deemed paid by P for 1987 and 1988 under section 960(a)(1) and section 902(a) are determined as follows on the basis of the following facts and computations.

* * * * *

Par. 6. Section 1.904–7 is amended as follows:

1. Paragraph (a) is revised as set forth below.

2. Paragraph (c) is amended by removing the reference "453(A)" and adding in its' place "453A".

3. Paragraph (d) is amended by removing the reference "§ 1.904–6(d)" and adding in its place "§ 1.904–4(d)".

§ 1.904–7 Transition rules.

(a) *Characterization of distributions and section 951(a)(1) (A) (ii) and (iii) and (B) inclusions of earnings of a controlled foreign corporation accumulated in taxable years beginning before January 1, 1987, during taxable years of both the payor controlled foreign corporation and the recipient which begin after December 31, 1986—*

(1) *Distributions and section 951(a)(1) (A) (ii) and (iii) and (B) inclusions.* Earnings accumulated in taxable years beginning before January 1, 1987, by a foreign corporation that was a controlled foreign corporation when such earnings were accumulated are characterized in that foreign corporation's hands under section 904(d)(1)(A) (separate limitation interest income) or section 904(d)(1)(E) (general limitation income) (prior to their amendment by the Tax Reform Act of 1986 (the Act)) after application of the de minimis rule of former section 904(d)(3)(C) (prior to its amendment by the Act). When, in a taxable year after the effective date of the Act, earnings and profits attributable to such income are distributed to, or included in the gross income of, a United States shareholder under section 951(a)(1) (A) (ii) or (iii) or (B) (hereinafter in this section "inclusions"), the ordering rules of section 904(d)(3)(D) and § 1.904–5(c)(4) shall be applied in determining initially the character of the income of the distributee or United States shareholder. Thus, a proportionate amount of a distribution described in this paragraph initially will be characterized as separate limitation interest income in the hands of the distributee based on the ratio of the separate limitation interest earnings and profits out of which the dividend was paid to the total earnings and profits out of which the dividend was paid. The distribution or inclusions must then be recharacterized in the hands of the distributee or United States shareholder on the basis of the following principles:

(i) Distributions and inclusions that initially are characterized as separate limitation interest income shall be treated as passive income;

(ii) Distributions and inclusions that initially are characterized as old general limitation income shall be treated as general limitation income, unless the taxpayer establishes to the satisfaction of the Commissioner that the distribution or inclusion is attributable to:

(A) Earnings and profits accumulated with respect to shipping income, as defined in section 904(d)(2)(D) and § 1.904–4(f); or

(B) In the case of a financial services entity, earnings and profits accumulated with respect to financial services income, as defined in section 904(d)(2)(C)(ii) and § 1.904–4(e)(1); or

(C) Earnings and profits accumulated with respect to high withholding tax interest, as defined in section 904(d)(2)(B) and § 1.904–4(d).

(2) *Limitation on establishing the character of earnings and profits.* In order for a taxpayer to establish that distributions or inclusions that are attributable to general limitation earnings and profits of a particular taxable year beginning before January 1, 1987, are attributable to shipping, financial services or high withholding tax interest earnings and profits, the taxpayer must establish the amounts of foreign taxes paid or accrued with respect to income attributable to those earnings and profits that are to be treated as taxes paid or accrued with respect to shipping, financial services or high withholding tax interest income, as the case may be, under section 904(d)(2)(I). Conversely, in order for a taxpayer to establish the amounts of general limitation taxes paid or accrued in a taxable year beginning before January 1, 1987, that are to be treated as taxes paid or accrued with respect to shipping, financial services or high withholding tax interest income, as the case may be, the taxpayer must establish the amount of any distributions or inclusions that are attributable to shipping, financial services or high withholding tax interest earnings and profits. For purposes of establishing the amounts of general limitation taxes that are to be treated as taxes paid or accrued with respect to shipping, financial services or high withholding tax interest income, the principles of § 1.904–6 shall be applied.

* * * * *

§ 1.905–2 [Amended]

Par. 7. Section 1.905–2 is amended as follows:

1. Paragraph (c) is removed.

2. Paragraph (d) is redesignated as paragraph (c).

David G. Blattner,

Acting Commissioner of Internal Revenue.

Approved: January 24, 1992.

Kenneth W. Gideon,

Assistant Secretary of the Treasury.

[FR Doc. 92–8497 Filed 5–13–92; 8:45 am]

BILLING CODE 4830–01–M

DEPARTMENT OF JUSTICE

28 CFR Part 16

[AAG/A Order No. 66–92]

Exemption of Records System Under the Privacy Act

AGENCY: Department of Justice.

ACTION: Final Rule.

SUMMARY: The Department of Justice is exempting a Privacy Act system of records entitled "U.S. Marshals Service Prisoner Processing and Population Management System, JUSTICE/USM–005," from the provisions of 5 U.S.C. 552a(c)(3) and (4), (d), (e)(1), (2), (3), (e)(5) and (e)(8) and (g). The exemptions are necessary to protect the security of prisoners, witnesses and informants, law enforcement personnel, and the public; and to prevent a serious threat to law enforcement activities and law enforcement communications systems.

EFFECTIVE DATE: This rule will be effective May 14, 1992.

FOR FURTHER INFORMATION CONTACT: Patricia E. Neely (202) 616–0178.

SUPPLEMENTARY INFORMATION: A proposed rule with invitation to comment was published in the **Federal Register** on February 3, 1992 (57 FR 3974). The public was given 30 days in which to comment. One public comment favoring the exemptions was received.

This order relates to individuals rather than small business entities. Nevertheless, pursuant to the requirements of the Regulatory Flexibility Act, 5 U.S.C. 601–612, it is hereby stated that the order will not have a "significant economic impact on a substantial number of small entities."

List of Subjects in 28 CFR Part 16

Administrative Practice and Procedure; Courts; Freedom of Information; Privacy; Sunshine Act.

Pursuant to the authority vested in the Attorney General by 5 U.S.C. 552a and delegated to me by Attorney General Order 793–78, 28 CFR part 16 is amended as set forth below.

Dated May 1, 1992.

Harry H. Flickinger,

Assistant Attorney General for Administration.

1. The authority for part 16 continues to read as follows:

Authority: 5 U.S.C. 301, 552, 552a, 552b(g), 553; 18 U.S.C. 4203(a)(1); 28 U.S.C. 509, 510, 534; 31 U.S.C. 3717, 9701.

2. 28 CFR 16.101 is amended by redesignating paragraph (q) as paragraph (s) [1] and by adding new paragraphs (q) and (r).

§ 16.101 Exemption of U.S. Marshals Service (USMS) Systems—limited access, as indicated

* * * * *

(q) The following system of records is exempt from 5 U.S.C. 552a(c)(3) and (4), (d), (e)(1), (2), (3), (e)(5) and (e)(8) and (g):

(1) U.S. Marshals Service Prisoner Processing and Population Management System (JUSTICE/USM–005).

These exemptions apply only to the extent that information in this system is subject to exemption pursuant to 5 U.S.C. 552a(j)(2).

(r) Exemptions from the particular subsections are justified for the following reasons:

(1) From subsection (c)(3) because to release the disclosure accounting would permit the subject of a criminal proceeding to determine the extent or nature of law enforcement authorities' knowledge regarding his/her alleged misconduct or criminal activities. The disclosure of such information could alert the subject to devise ways in which to conceal his/her activities and/or prevent law enforcement from learning additional information about his/her activities, or otherwise inhibit law enforcement efforts. In addition, where the individual is the subject of an ongoing or potential inquiry/investigation, such release could reveal the nature thereof prematurely, and may also enable the subject to determine the identity of witnesses and informants. Such disclosure could compromise the ongoing or potential inquiry/investigation, endanger the lives of witnesses and informants, or otherwise impede or thwart law enforcement efforts.

(2) From subsection (c)(4) to the extent that the system is exempt from subsection (d).

(3) From subsection (d) because to permit unlimited access would permit the subject of a criminal proceeding to determine the extent or nature of law enforcement authorities' knowledge regarding his/her alleged misconduct or criminal activities. The disclosure of such information could alert the subject to devise ways in which to conceal his/her activities and/or prevent law enforcement from learning additional information about his/her activities, or otherwise inhibit law enforcement efforts. Disclosure would also allow the subject to obtain sensitive information concerning the existence and nature of security measures and jeopardize the safe and secure transfer of the prisoner, the safety and security of other prisoners, informants and witnesses, law enforcement personnel, and the public. In addition, disclosure may enable the subject to learn prematurely of an ongoing or potential inquiry/investigation, and may also permit him/her to determine the identities of confidential sources, informants, or protected witnesses. Such disclosure could compromise the ongoing or potential inquiry/investigation, endanger the lives of witnesses and informants, or otherwise impede or thwart law enforcement efforts. Disclosure may also constitute an unwarranted invasion of the personal privacy of third parties. Further, disclosure would reveal access codes, data entry codes and message routing symbols used in law enforcement communications systems. Access to such codes and symbols would permit the subject to impede the flow of law enforcement communications and compromise the integrity of law enforcement information, and thus present a serious threat to law enforcement activities. To permit amendment of the records would expose security matters, and would impose an impossible administrative burden by requiring that security precautions, and information pertaining thereto, be continuously reevaluated if contested by the prisoner, or by anyone on his or her behalf. Similarly, to permit amendment could interfere with ongoing or potential inquiries/investigations by requiring that such inquiries/investigations be continuously reinvestigated, or that information collected (the relevance and accuracy of which cannot readily be determined) be subjected to continuous change.

(4) From subsections (e)(1) and (5) because the system may contain investigatory information or information which is derived from information collected during official criminal investigations. In the interest of effective law enforcement and litigation, of securing the prisoner and of protecting the public, it may be necessary to retain information the relevance, necessity, accuracy, timeliness and completeness of which cannot be readily established. Such information may nevertheless provide investigative leads to other Federal or law enforcement agencies, or prove necessary to establish patterns of criminal activity or behavior, and/or prove essential to the safe and secure detention (and movement) of prisoners. Further, the provisions of (e)(1) and (e)(5) would restrict the ability of the USMS in exercising its judgment in reporting information during investigations or during the development of appropriate security measures, and thus present a serious impediment to law enforcement efforts.

(5) From subsection (e)(2) because the requirement to collect information from the subject individual would impede the information collection responsibilities of the USMS which is often dependent upon sources other than the subject individual for verification of information pertaining to security risks posed by the individual prisoner, to alleged misconduct or criminal activity of the prisoner, or to any matter affecting the safekeeping and disposition of the individual prisoner.

(6) From subsection (e)(3) because to inform individuals as required by this subsection could impede the information gathering process, reveal the existence of an ongoing or potential inquiry/investigation or security procedure, and compromise law enforcement efforts.

(7) From subsection (e)(8) because to serve notice would give persons sufficient warning to compromise an ongoing or potential inquiry/investigation and thereby evade and

[1] Paragraph (o) was redesignated as paragraph (q) in a final rulemaking at 57 FR 3283 on January 29, 1992.

impede law enforcement and security efforts.

(8) From subsection (g) to the extent that the system is exempt from subsection (d).

* * * * *

[FR Doc. 92-11336 Filed 5-13-92; 8:45 am]

BILLING CODE 4410-01-M

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 675

[Docket No. 911172-2018]

Groundfish of the Bering Sea and Aleutian Islands Area

AGENCY: National Marine Fisheries Service (NMFS), NOAA, Commerce.

ACTION: Closure to directed fishing.

SUMMARY: The Director, Alaska Region, NMFS (Regional Director), has determined that the allowances of prohibited species catch (PSC) of red king crab and *C. bairdi* Tanner crab (Tanner crab) to the pollock/Atka mackerel/"other species" fishery in bycatch limitation zone 1 (Zone 1) and the allowance of PSC of Tanner crab to the Pacific cod fishery in Zone 1 of the Bering Sea and Aleutian Islands Management area (BSAI) have been caught. NMFS is prohibiting directed fishing for pollock by trawl vessels using non-pelagic trawl gear, and Pacific cod by vessels using any trawl gear in Zone 1 of the BSAI. This action is necessary to prevent the bycatch allowances of red king crab and Tanner crab to the pollock/Atka mackerel/"other species" fishery and the bycatch allowance of Tanner crab to the Pacific cod fishery from being exceeded. This action is to ensure optimum use of groundfish while conserving red king crab and Tanner crab stocks.

DATES: Effective 12 noon, Alaska local time (A.l.t.), May 13, 1992, through 12 midnight, A.l.t., December 31, 1992.

FOR FURTHER INFORMATION CONTACT: Andrew N. Smoker, Resource Management Specialist, NMFS, 907-586-7228.

SUPPLEMENTARY INFORMATION: The groundfish fishery in the exclusive economic zone within the BSAI is managed by the Secretary of Commerce according to the Fishery Management Plan for the Groundfish Fishery of the Bering Sea and Aleutian Islands Area (FMP) prepared by the North Pacific Fishery Management Council under authority of the Magnuson Fishery Conservation and Management Act. The FMP is implemented by regulations at 50 CFR 611.93 and parts 620 and 675.

Regulations appearing at 675.21(a) establish PSC limits of red king crab and Tanner crab in specific zones of the Bering Sea subarea (BS). Under §§ 675.21(a) (1) and (2), the PSC limit of red king crab caught while conducting any domestic annual harvest (DAH) trawl fishery for groundfish in Zone 1, as defined at § 675.2, is 200,000 animals. Likewise, the PSC limit of Tanner crab caught while conducting any DAH trawl fishery for groundfish in Zone 1 is 1,000,000 animals. Further, § 675.21(g)(1) provides that the PSC limits of red king crab and Tanner crab be subsequently apportioned into bycatch allowances that are assigned in part to the pollock/Atka mackerel/"other species" fishery and to the Pacific cod fishery under § 675.21(g)(4).

An emergency interim rule (57 FR 11433, April 3, 1992) established the 1992 Zone 1 red king crab allowance for the pollock/Atka mackerel/"other species" fishery at 30,000 animals, the 1992 Zone 1 Tanner crab allowance for the pollock/Atka mackerel/"other species" fishery at 125,000 animals, and the 1992 Zone 1 Tanner crab allowance for the Pacific cod fishery at 75,000 animals.

Under § 675.21(h)(1)(i), the Regional Director has determined that U.S. fishing vessels using trawl gear have caught the 1992 Zone 1 PSC allowances of red king crab and Tanner crab while participating in the pollock/Atka mackerel/"other species" fishery and the 1992 Zone 1 PSC allowance of Tanner crab while participating in the Pacific cod fishery. NMFS is closing Zone 1 in the BSAI to directed fishing for the remainder of the year for: (a) pollock by trawl vessels using non-pelagic trawl gear; and (b) Pacific cod by vessels using trawl gear, from 12 noon, A.l.t., May 13, 1992, through 12 midnight, A.l.t, December 31, 1992.

Directed fishing standards for applicable gear types may be found in the regulations at § 675.20(h) and 57 FR 11433 (April 3, 1992).

Classification

This action is taken under 50 CFR 675.21 and complies with E.O. 12291.

List of Subjects in 50 CFR Part 675

Fisheries, Reporting and recordkeeping requirements.

Authority: 16 U.S.C 1801 *et seq.*

Joe P. Clem,

Acting Director of Office Fisheries Cnnservation and Management, Notional Marine Fisheries Service.

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