

LB&I Process Unit

Knowledge Base – Repatriation (Business Outbound)

Library Level	Number	Title
Shelf	–	Business Outbound
Book	4	Repatriation (Business Outbound)
Chapter	4.1	Investment in U.S. Property
Section	4.1.3	Determination of Amount of Investment in U.S. Property (e.g., determination of basis in investment and CFC E&P)
Subsection	N/A	N/A
Unit Name	Calculation of the IRC 956 Inclusion	
Primary UIL Code	9414.01-03	Determination of Amount of Investment in U.S. Property (e.g., determination of basis in investment and CFC E&P)

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Process Overview

Calculation of the IRC 956 Inclusion

- This Practice Unit provides a process to calculate the IRC 956 Inclusion.
- U.S. corporations with substantial foreign operations typically conduct business in foreign jurisdictions primarily through controlled foreign corporations as defined in IRC 957 (“CFCs”). Income earned by a CFC is generally not included in the income of its U.S. owner until the U.S. owner receives a dividend. Subpart F, however, requires certain amounts to be included currently. IRC 951(a)(1)(B) and 956 create a mechanism pursuant to which the CFC’s ownership of certain assets that meet the definition of United States property (“US property”) may give rise to a current income inclusion (an “IRC 956 Inclusion”) to a United States shareholder as defined in IRC 951(b) (“US shareholder”) with respect to the CFC.
- Multiple calculations are required to determine the IRC 956 Inclusion. First, the quarterly average amount of US property held by a CFC, net of certain specific liabilities, must be determined. Then a series of E&P-based calculations must be performed. To complete these calculations, it is necessary to determine the amount and category, as defined in IRC 959(c), of both current and accumulated E&P. These calculations generally prevent multiple inclusions in income with respect to an item of US property held by a CFC. They also generally prevent an income inclusion when a distribution from a CFC would not have given rise to a dividend.


Process Applicability

Calculation of the IRC 956 Inclusion

Much of the information needed to calculate an IRC 956 Inclusion can be found on the tax return. The identification of US property, its adjusted tax basis and the liabilities to which the property is subject will likely require additional information from the taxpayer.

Criteria	Resources
<ul style="list-style-type: none">▪ The examiner believes that a CFC holds significant obligations of a related US person.	<ul style="list-style-type: none">▪ Review Form 5471, Schedule M. Columns (b) and (c) of line 26 will indicate loans between the CFC and a related US person. It will not, however, indicate service and trade receivables of such persons held by the CFC.
<ul style="list-style-type: none">▪ The examiner believes that a CFC holds significant tangible assets located in the United States.	<ul style="list-style-type: none">▪ The CFC's trial balance can give guidance as to what tangible assets are owned by the CFC. The asset's location is typically determined by asking the taxpayer or by a review of public records such as a 10-K or the taxpayer's website.

Process Applicability (cont'd)

Calculation of the IRC 956 Inclusion	
Criteria	Resources
<ul style="list-style-type: none"> ▪ The examiner believes that a CFC holds significant IP that is held for use in the United States and/or the CFC holds stock in a domestic, related corporation. 	<ul style="list-style-type: none"> ▪ License fees or royalties may indicate IP used in the United States. Dividends received from a related US person may indicate stock ownership. Review Form 5471, Schedule M, especially columns (b) and (c) of lines 8 and 9.
<ul style="list-style-type: none"> ▪ The examiner identifies an amount of 959(c)(1) E&P that is small when compared to the amount of US property held by the CFC. <p> CONSULTATION: If it appears that the funds used to acquire US property came from another CFC, the examiner should work with local counsel to determine if the IRC 956 anti-avoidance rules are applicable.</p>	<ul style="list-style-type: none"> ▪ The 959(c)(1) E&P is reported in column (c)(i) on Form 5471, Schedule J. Loans, contributions and certain other transfers to the CFC from a foreign corporation controlled by the CFC's US shareholder(s) may suggest structuring to avoid an IRC 956 Inclusion. Review Form 5471, Schedule M, specifically column (d) of line 25 for loans.

Summary of Process Steps

Calculation of the IRC 956 Inclusion

Process Steps

We provide below a 10 step process to calculate an IRC 956 Inclusion.

Step 1	Identify US property held or treated as held by the CFC.
Step 2	Determine the amount of US property taken into account on the last day of each of the CFC's quarters. Reduce this amount by the liabilities to which the US property is subject that constitute specific charges.
Step 3	Add the four quarter-end balances together and divide by four to get the quarterly average, and determine the US shareholder's pro rata share of that amount.
Step 4	Determine the amounts and categories (959(c)(1) E&P, 959(c)(2) E&P, and 959(c)(3) E&P) of current and accumulated E&P. These amounts are determined before taking current year distributions into account.

Summary of Process Steps (cont'd)

Calculation of the IRC 956 Inclusion

Process Steps

We provide below a 10 step process to calculate an IRC 956 Inclusion.

Step 5	Determine the amount of actual current year distributions.
Step 6	Use the information in the above steps to calculate the Adjusted US Property.
Step 7	Use the information in the above steps to calculate US shareholder's pro rata share of Applicable Earnings.
Step 8	Determine the IRC 956 Amount: Lesser of Adjusted US Property or US shareholder's pro rata share of Applicable Earnings.

Summary of Process Steps (cont'd)

Calculation of the IRC 956 Inclusion

Process Steps

We provide below a 10 step process to calculate an IRC 956 Inclusion.

[Step 9](#)

Determine the IRC 956 Inclusion. Make all required adjustments to IRC 959(c) categories of E&P.

[Step 10](#)

If the amount determined in Step 9 is in a currency other than the US dollar, translate that amount to US dollars using the spot rate on the last day of the CFC's taxable year for which such amount is included.

Step 1: Identify US Property

Calculation of the IRC 956 Inclusion

Step 1

Identify US property held or treated as held by the CFC.

Considerations	Resources
<ul style="list-style-type: none"> ▪ US property is generally defined to include: <ul style="list-style-type: none"> – Tangible property located in the United States; – Stock of a domestic corporation; – An obligation of a United States person; and – Any right to use in the United States certain intangibles which are acquired or developed by the CFC for use in the United States. 	<ul style="list-style-type: none"> ▪ IRC 956(c)(1) ▪ Treas. Reg. 1.956-2(a)
<ul style="list-style-type: none"> ▪ Certain trade or service receivables acquired from a related United States person will also be considered US property. 	<ul style="list-style-type: none"> ▪ IRC 956(c)(3) ▪ Treas. Reg. 1.956-3
<ul style="list-style-type: none"> ▪ In addition, a CFC may be treated as holding an obligation of a US person if the CFC is a pledgor or guarantor of such obligation or if the assets of the CFC serve, even if indirectly, as security for the performance of the obligation. 	<ul style="list-style-type: none"> ▪ IRC 956(d) ▪ Treas. Reg. 1.956-2(c)
<ul style="list-style-type: none"> ▪ If an inversion transaction takes place, additional items may constitute US property. This will include certain obligations of a foreign person, whether the CFC actually holds them or is treated as a pledgor or guarantor of them, and certain stock of a foreign corporation. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.956-2T(a)(4) ▪ Treas. Reg. 1.956-2T(c)(5)

Step 1: Identify US Property (cont'd)

Calculation of the IRC 956 Inclusion

Step 1

Considerations	Resources
<ul style="list-style-type: none"> ▪ For purposes of IRC 956, a CFC that indirectly holds property through a partnership is generally treated as holding its attributable share of the partnership's property. 	<ul style="list-style-type: none"> ▪ See Treas. Reg. 1.956-4(b) for special rules governing property held indirectly through a partnership
<ul style="list-style-type: none"> ▪ For purposes of IRC 956, an obligation of a foreign partnership is generally treated as obligations of the partners in the partnership, whereas an obligation of a domestic partnership is generally considered US property unless an exception applies. 	<ul style="list-style-type: none"> ▪ See Treas. Reg. 1.956-4(c) and 1.956-4(e) for special rules governing obligations of a partnership
<ul style="list-style-type: none"> ▪ IRC 956(c)(2) sets forth exceptions to the definition of US property. These exceptions exclude from US property, among other items, certain trade receivables as well as obligations of an unrelated United States person. 	<ul style="list-style-type: none"> ▪ IRC 956(c)(2) ▪ Treas. Reg. 1.956-2(b) ▪ See also Treas. Reg. 1.956-2T(d)(2)
<ul style="list-style-type: none"> ▪ There is also an exception for certain short-term obligations. 	<ul style="list-style-type: none"> ▪ Practice Unit: Short Term Loan Exclusion from United States Property ▪ Treas. Reg. 1.956-2T(d)(2)(iv) and (v)
<ul style="list-style-type: none"> ▪ US property acquired by a foreign corporation before it becomes a CFC is disregarded. The aggregate amount disregarded can not exceed the Applicable Earnings accumulated before the foreign corporation becomes a CFC. 	<ul style="list-style-type: none"> ▪ IRC 956(b)(2)
<ul style="list-style-type: none"> ▪ Accrued, unpaid interest on a loan is US property. 	<ul style="list-style-type: none"> ▪ See CCA 201436047

Step 1: Identify US Property (cont'd)

Calculation of the IRC 956 Inclusion

[Step 1](#)

Considerations	Resources
<ul style="list-style-type: none">▪ On the tax return, Schedule M and Schedule F of Form 5471 are often useful in identifying US property.<ul style="list-style-type: none">- Schedule M should reflect loans to as well as royalties and license fees received from related US persons. In columns (b) and (c) of line 26, the taxpayer should indicate loans from the CFC to certain related US persons. Line 26 will not, however, indicate service and trade receivables held by the CFC. Columns (b) and (c) of line 8 should reflect royalties and license fees the CFC received from certain related US persons.- Schedule F should provide a balance sheet for the CFC.	<ul style="list-style-type: none">▪ Form 5471, Schedule F and M
<ul style="list-style-type: none">▪ Items such as board minutes, transfer pricing studies, trial balance detail, 10-K documents and taxpayer websites can also be useful in identifying US property.	

Step 2: Determine US Property at Quarter Ends

Calculation of the IRC 956 Inclusion

Step 2

Determine the amount of US property taken into account on the last day of each of the CFC's quarters. Reduce this amount by the liabilities to which the US property is subject that constitute specific charges.

Considerations	Resources
<ul style="list-style-type: none"> ▪ The amount of US property taken into account is generally the property's adjusted basis, not its fair market value. If a CFC acquires US property using nonfunctional currency, the basis of that asset is translated to functional currency using the spot rate on the date of acquisition. 	<ul style="list-style-type: none"> ▪ IRC 956(a) ▪ Treas. Reg. 1.956-1(e) ▪ Treas. Reg. 1.964-1(b)(1)(v) ▪ Treas. Reg. 1.988-2(a)(2)(ii)(B)
<ul style="list-style-type: none"> ▪ In the case of US property treated as held by a CFC due to a pledge or guarantee, the amount taken into account is the unpaid principal amount of the obligation. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.956-2(c) ▪ Treas. Reg. 1.956-1(e)(2)
<ul style="list-style-type: none"> ▪ Property is considered acquired by a foreign corporation when such corporation acquires an adjusted basis in the property, or, in the case of property treated as held by a CFC as a result of being (or being considered) a pledgor or guarantor, when the CFC becomes liable as a pledgor or guarantor or is otherwise considered a pledgor or guarantor. While attachments to the tax return may provide date of acquisition information, it is often necessary to determine acquisition dates from the taxpayer's books and records. Examination of loan agreements, wire transfers, bill of sale documentation and other similar items are often useful in determining and verifying acquisition dates and basis. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.956-2(d)(1)(i)(a)

Step 2: Determine US Property at Quarter Ends (cont'd)

Calculation of the IRC 956 Inclusion

[Step 2](#)

Considerations	Resources
<ul style="list-style-type: none"> ▪ To reduce the amount of US property, the liability must be a specific charge against the property involved. If the liability is evidenced by an open account or is secured only by the general credit of the CFC, it will not be taken into account. A mortgage agreement, UCC-1 filing or other similar evidence of security interest in the US property held by the creditor may support treatment as a specific charge. 	<ul style="list-style-type: none"> ▪ IRC 956(a) ▪ Treas. Reg. 1.956-1(e)(1) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII, B
<ul style="list-style-type: none"> ▪ If a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability must be apportioned based on the relative adjusted basis of each item of property. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.956-1(e)(1) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII, B
<ul style="list-style-type: none"> ▪ If a liability that constitutes a specific charge is in excess of the adjusted basis of the property that secures it, it can only be used to reduce the specific item of property to zero, but not below zero. The liability will not be taken into account to reduce the adjusted basis of other property that is not subject to it. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.956-1(e)(1) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII, B

Step 2: Determine US Property at Quarter Ends (cont'd)

Calculation of the IRC 956 Inclusion

[Step 2](#)


Considerations	Resources
<ul style="list-style-type: none">▪ A specific charge created with respect to any item of property principally for the purpose of artificially increasing or decreasing the amount of a CFC's US property is disregarded.	<ul style="list-style-type: none">▪ Treas. Reg. 1.956-1(e)(3)▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII, B
<ul style="list-style-type: none">▪ If a US shareholder reduces US property through specific charges, it is required to attach a statement to its return giving detail on the adjusted basis of the US property before the reduction and the amount and nature of the reduction.	<ul style="list-style-type: none">▪ Treas. Reg. 1.956-1(e)(4)▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII, B

Step 3: Determine the Quarterly Average

Calculation of the IRC 956 Inclusion

Step 3

Add the four quarter-end balances together and divide by four to get the quarterly average, and determine the US shareholder's pro rata share of that amount.

Considerations	Resources
<ul style="list-style-type: none"> ▪ If a CFC does not hold US property on the last day of a quarter, zero should be included for that quarter when determining the quarterly average. 	
<ul style="list-style-type: none"> ▪ If a foreign corporation ceases to be a CFC during the tax year: <ul style="list-style-type: none"> – The US shareholder's pro rata share is determined by looking at stock ownership on the last day during the tax year on which the foreign corporation is a CFC; – Only quarters ending on or before the last day on which the foreign corporation is a CFC are taken into account; and – When you calculate Applicable Earnings, only take into account current year E&P allocable (on a pro rata basis) to the part of the year for which the foreign corporation is a CFC. For example, if the foreign corporation was a CFC for one-fourth of the tax year, only take into account one-fourth of the current E&P when calculating Applicable Earnings. 	<ul style="list-style-type: none"> ▪ IRC 956(b)(3)
 <p>CONSULTATION: If a CFC has a short taxable year, the examiner should work with local counsel to determine the average amount of US property held by the CFC for the year.</p>	

Step 4: Determine Amount and Category of E&P

Calculation of the IRC 956 Inclusion

Step 4

Determine the amounts and categories (959(c)(1) E&P, 959(c)(2) E&P, and 959(c)(3) E&P) of current and accumulated E&P. These amounts are determined before taking current year distributions into account.

Considerations	Resources
<ul style="list-style-type: none"> ▪ IRC 959(c) divides E&P into three categories. The three categories are: <ul style="list-style-type: none"> – 959(c)(1) E&P, which includes E&P attributable to IRC 956 Inclusions and amounts that would have been attributable to IRC 956 Inclusions but were not because 959(c)(2) E&P reduced the amount that was included in the US shareholder’s income; – 959(c)(2) E&P, which includes E&P attributable to inclusions of Subpart F income (including current year Subpart F income); and – 959(c)(3) E&P, which refers to all other E&P. 	<ul style="list-style-type: none"> ▪ IRC 959(c) ▪ IRC 959(a)(2) ▪ IRC 959(f)(1)
<ul style="list-style-type: none"> ▪ 959(c)(1) E&P and 959(c)(2) E&P amounts are often referred to as previously taxed income, PTI or previously taxed E&P. ▪ 959(c)(3) E&P amounts are often referred to as untaxed E&P, or non-PTI E&P. 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule J
<ul style="list-style-type: none"> ▪ Form 5471, Schedule J provides both current and accumulated amounts for all of the categories of E&P: <ul style="list-style-type: none"> – 959(c)(1) E&P amounts are in columns (c)(i) and (ii), – 959(c)(2) E&P amounts are in column (c)(iii), and – 959(c)(3) E&P amounts are in columns (a) and (b). 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule J

Step 4: Determine Amount and Category of E&P (cont'd)

Calculation of the IRC 956 Inclusion

Step 4

Considerations	Resources
<ul style="list-style-type: none"> ▪ Form 5471, Schedule J, column (c)(ii) refers to earnings invested in Excess Passive Assets. <ul style="list-style-type: none"> – This is an additional type of 959(c)(1) E&P. – IRC 956A, which required the inclusion of this type of income, was repealed in 1996, but some taxpayers still have the E&P relating to pre-1997 inclusions. 	<ul style="list-style-type: none"> ▪ IRC 959(c)(1)(B) ▪ PL 104-188, Sec. 1501(a)(2), which repealed IRC 956A
<ul style="list-style-type: none"> ▪ Taxpayers typically have workpapers showing how the amounts on Form 5471, Schedule J were determined. An examiner can request these workpapers. 	
<ul style="list-style-type: none"> ▪ A reclassification of E&P from 959(c)(2) E&P to 959(c)(1) E&P may be required as a result of the application of IRC 959(a)(2). <ul style="list-style-type: none"> – IRC 959(a)(2) reduces the IRC 956 Amount (calculated in Step 8) by the amount of the 959(c)(2) E&P to determine the IRC 956 Inclusion. See Step 9. – To the extent that such a reduction occurs, 959(c)(2) E&P is converted to 959(c)(1) E&P. 	<ul style="list-style-type: none"> ▪ IRC 959(a)(2), IRC 959(c)(1) and IRC 959(f)(1) ▪ Prop. Treas. Reg. 1.959-3(b)(3) ▪ Prop. Treas. Reg. 1.959-3(e)(2)(iv)
<ul style="list-style-type: none"> ▪ Reclassifications can be found on Form 5471, Schedule J on lines 4 and 5a. As other items are also included in these lines, it may be necessary to review taxpayer's workpapers to isolate the reclassification. 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule J

Step 5: Determine Amount of Distributions

Calculation of the IRC 956 Inclusion

Step 5

Determine the amount of actual current year distributions.

Considerations	Resources
<ul style="list-style-type: none"> ▪ Distributions by E&P category are reported on Form 5471, Schedule J. <ul style="list-style-type: none"> – Line 5a reports the distributions out of 959(c)(1) E&P and 959(c)(2) E&P. While reclassifications may be contained in this line, the net amount should reflect distributions out of PTI. – Line 5b reports distributions out of 959(c)(3) E&P. 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule J
<ul style="list-style-type: none"> ▪ IRC 959(c) provides ordering rules that treat 959(c)(1) E&P as distributed first, then 959(c)(2) E&P, and then 959(c)(3) E&P. 	<ul style="list-style-type: none"> ▪ IRC 959(c)
<ul style="list-style-type: none"> ▪ Distribution amounts are necessary to compute: <ul style="list-style-type: none"> – Adjusted US Property which is calculated in Step 6 (there is a reduction for undistributed 959(c)(1) E&P); – Applicable Earnings which is calculated in Step 7; and – The IRC 956 Inclusion in Step 9 (there is a reduction for undistributed 959(c)(2) E&P). 	

Step 6: Calculate Adjusted US Property

Calculation of the IRC 956 Inclusion

Step 6

Use the information in the above steps to calculate the Adjusted US Property.

Considerations	Resources
<ul style="list-style-type: none">▪ Adjusted US Property is a term coined for this Practice Unit and is not found in the IRC or regulations.<ul style="list-style-type: none">- It refers to the amount set out in IRC 956(a)(1).- It is (i) the US shareholder's share of the quarterly average of the US property, which was determined in Step 3, reduced by- (ii) the accumulated beginning of year ("BOY") 959(c)(1) E&P amount with respect to the US shareholder determined in Step 4 less distributions of 959(c)(1) E&P that affect the US shareholder's 959(c)(1) E&P account made during the year.- IRC 959(c) provides ordering rules that treat 959(c)(1) E&P as distributed first, then 959(c)(2) E&P, and then 959(c)(3) E&P.	<ul style="list-style-type: none">▪ IRC 956(a)(1) and IRC 959(c)

Step 7: Calculate Applicable Earnings

Calculation of the IRC 956 Inclusion
Step 7
Use the information in the above steps to calculate US shareholder's pro rata share of Applicable Earnings.

Considerations	Resources
<ul style="list-style-type: none"> ▪ Applicable Earnings is: <ul style="list-style-type: none"> - Current year E&P plus - Positive accumulated BOY E&P (all three categories combined), minus - Distributions made during the year, minus - Accumulated BOY 959(c)(1) E&P after taking into account 959(c)(1) E&P distributed during the year. 	<ul style="list-style-type: none"> ▪ IRC 956(a)(2) ▪ IRC 956(b)(1)

Step 8: Determine IRC 956 Amount

Calculation of the IRC 956 Inclusion

Step 8

Determine the IRC 956 Amount: Lesser of Adjusted US Property or US shareholder's pro rata share of Applicable Earnings.

Considerations	Resources
<ul style="list-style-type: none">▪ Determine the lesser of (i) Adjusted US Property or (ii) the US shareholder's pro rata share of Applicable Earnings. The result is the IRC 956 Amount.	<ul style="list-style-type: none">▪ IRC 956(a)▪ IRC 959(a)(2)▪ IRC 959(f)(1)

Step 9: Determine IRC 956 Inclusion

Calculation of the IRC 956 Inclusion

Step 9

Determine the IRC 956 Inclusion. Make all required adjustments to IRC 959(c) categories of E&P.

Considerations	Resources
<ul style="list-style-type: none"> ▪ Reduce the IRC 956 Amount by the sum of: (1) the undistributed, accumulated BOY 959(c)(2) E&P and (2) the undistributed, current year 959(c)(2) E&P with respect to the US shareholder to determine the IRC 956 Inclusion. 	<ul style="list-style-type: none"> ▪ IRC 956(a) ▪ IRC 959(a)(2) ▪ IRC 959(f)(1)
<ul style="list-style-type: none"> ▪ To the extent that the IRC 956 Amount is reduced in this Step 9, E&P will be reclassified from 959(c)(2) E&P to 959(c)(1) E&P as a result of the application of IRC 959(a)(2). 	<ul style="list-style-type: none"> ▪ IRC 959(a)(2), IRC 959(c)(1) and IRC 959(f)(1) ▪ Prop. Treas. Reg. 1.959-3(b)(3) ▪ Prop. Treas. Reg. 1.959-3(e)(2)(iv)
<ul style="list-style-type: none"> ▪ An amount of E&P equal to the IRC 956 Inclusion will be reclassified from 959(c)(3) E&P to 959(c)(1) E&P. 	<ul style="list-style-type: none"> ▪ IRC 959(c)(1) ▪ Prop. Treas. Reg. 1.959-3(e)(2)(vii)

Step 10: Translate If Not in U.S. Dollars

Calculation of the IRC 956 Inclusion

Step 10

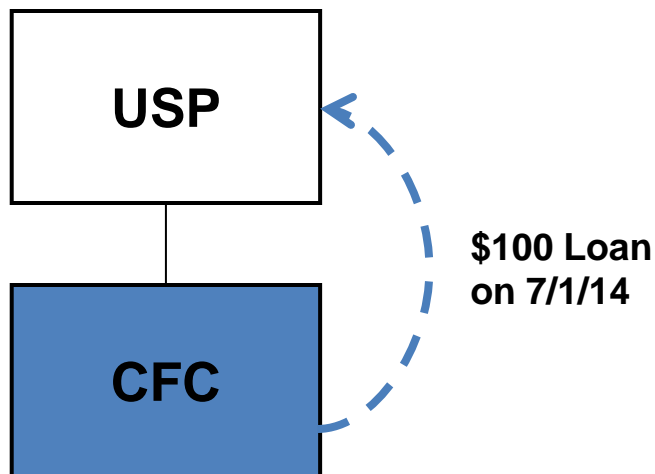
If the amount determined in Step 9 is in a currency other than the US dollar, translate that amount to US dollars using the spot rate on the last day of the CFC's taxable year for which such amount is included.

Considerations	Resources
<ul style="list-style-type: none">▪ The calculations performed in Steps 1-9 are done in the CFC's functional currency as E&P is generally required to be maintained in the CFC's functional currency.	<ul style="list-style-type: none">▪ IRC 986(b)
<ul style="list-style-type: none">▪ If the amount determined in Step 9 is in a currency other than the US dollar, it has to be translated. The appropriate translation rate is the spot rate on the last day of the CFC's taxable year for which such amount is included.	<ul style="list-style-type: none">▪ IRC 989(b)

Example of the Process

Calculation of the IRC 956 Inclusion

Example: Year 1



- Calendar year USP wholly owns a calendar year CFC
- Functional currency of CFC is US dollar
- On 7/1/2014, CFC loans USP \$100; the loan is outstanding through the year end
- CFC has the following attributes for 2014:
 - BOY: no 959(c)(1) E&P or 959(c)(2) E&P
 - BOY: 959(c)(3) E&P of (\$30)
 - Current year E&P of \$100 of which \$20 is Subpart F Income
- CFC makes a \$10 distribution in 2014
- CFC has no liabilities

- In 2014, USP must include \$40 in income as an IRC 956 Inclusion as required by IRC 951(a)(1)(B) and 956. The steps in this example show how to calculate the IRC 956 Inclusion.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 1: Identify US property held or treated as held by the CFC.
 - The \$100 loan is US property since it is an obligation of a US person and does not fall under an exception to the definition of US property.

 - Step 2: Determine the amount of the US property taken into account on the last day of each of the CFC's quarters. Reduce this amount by the liabilities to which the US property is subject that constitute specific charges.
 - No liability is a specific charge against the \$100 of US property.
 - End of quarter loan balances:

Q1 (March 31st)	\$ 0
Q2 (June 30th)	\$ 0
Q3 (September 30th)	\$100 (\$100 loan on 7/1/2014)
Q4 (December 31st)	\$100
- (Note: Example assumes no increase in US property due to unpaid, accrued interest.)

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 3: Add the four quarter-end balances together and divide by four to get the quarterly average and determine the US shareholder's pro rata share of that amount.

	Q1	Q2	Q3	Q4	Sum of Quarterly Balances	Sum Divided By Four
Quarter-End Balance	\$0	\$0	\$100	\$100	\$200	\$50

- Because USP owns 100% of CFC, USP's pro rata share is \$50.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 4: Determine the amounts and categories of current and accumulated E&P. These amounts are determined before taking current year distributions into account.

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
Accumulated BOY E&P	\$0	\$0	(\$30)	(\$30)
Current Year E&P	\$0	\$20	\$80	\$100
Current and Accumulated E&P	\$0	\$20	\$50	\$70

- Recall that current year E&P is \$100 of which \$20 is Subpart F Income. The \$20 of Subpart F Income is included in USP's income and is categorized as 959(c)(2) E&P while the remaining \$80 is categorized as 959(c)(3) E&P.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 5: Determine the amount of actual current year distributions.
\$10 distribution which will be from 959(c)(2) E&P under the IRC 959(c) ordering rules.

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
Current and Accumulated E&P	\$0	\$20	\$50	\$70
Distributions	\$0	(\$10)	\$0	(\$10)
E&P Before 956 Calculation	\$0	\$10	\$50	\$60

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 6: Use the information in the above steps to calculate the Adjusted US Property.

Adjusted US Property	
US shareholder's pro rata share of the Quarterly Average	\$50
Less accumulated BOY 959(c)(1) E&P with respect to the US shareholder reduced (but not below 0) by distributions of 959(c)(1) E&P that affect the shareholder's 959(c)(1) E&P account	0
Adjusted US Property	\$50

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 7: Use the information in the above steps to calculate US shareholder's pro rata share of Applicable Earnings.

Applicable Earnings	
Current Year E&P	\$100
Plus positive accumulated BOY E&P	0
Less distributions	(\$10)
Less accumulated BOY 959(c)(1) E&P with respect to the US shareholder reduced (but not below 0) by distributions of 959(c)(1) E&P	0
Applicable Earnings	\$90

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 8: IRC 956 Amount: Lesser of Adjusted US Property or US shareholder's pro rata share of Applicable Earnings.

IRC 956 Amount	
Adjusted US Property	\$50
Applicable Earnings	\$90
IRC 956 Amount: The lesser of the two numbers above	\$50

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

Step 9: Determine the IRC 956 Inclusion. Make all required adjustments to IRC 959(c) categories of E&P.

Undistributed Current Year 959(c)(2) E&P	
Current Year 959(c)(2) E&P	\$20
Less current year distribution of 959(c)(2) E&P	(\$10)
Undistributed, current year 959(c)(2) E&P	\$10

- Recall that CFC started the year with \$0 of 959(c)(2) E&P and had \$20 of Subpart F Income during 2014. The Subpart F Income inclusion by USP increased current year 959(c)(2) E&P to \$20, but that amount was reduced by the \$10 distribution.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

▪ Step 9 (cont'd)

IRC 956 Inclusion	
IRC 956 Amount	\$50
Less undistributed, accumulated BOY 959(c)(2) E&P	0
Less undistributed, current year 959(c)(2) E&P	(\$10)
IRC 956 Inclusion	\$40

- Since the IRC 956 Amount was reduced by \$10 in this step (from \$50 to \$40) to get the IRC 956 Inclusion, \$10 of E&P will be reclassified from 959(c)(2) E&P to 959(c)(1) E&P.
- Also, since the IRC 956 Inclusion is \$40, \$40 of E&P will be reclassified from 959(c)(3) E&P to 959(c)(1) E&P.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 9 (cont'd)

- Year-end E&P is calculated as follows:

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
E&P Before 956 Calculation	\$0	\$10	\$50	\$60
Reclassification Under IRC 959(a)(2)	\$10	(\$10)		
Current 956 Inclusion	\$40		(\$40)	
Year-End Balance	\$50	\$0	\$10	\$60

- E&P Before 956 Calculation was calculated in Step 5 and is the sum of (i) accumulated BOY E&P and (ii) current year E&P less distributions made during the tax year.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 1 (cont'd)

- Step 10: If the amount determined in Step 9 is in a currency other than the US dollar, translate that amount to US dollars using the spot rate on the last day of the CFC's taxable year for which such amount is included. See IRC 989(b) flush language.
 - The functional currency of the CFC is the US dollar, so the entire calculation is done in US dollars. No translation is necessary.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2

USP



USP

**\$100 Loan
on 7/1/14**

CFC

- For 2015, CFC has current year E&P of \$30 of which \$20 is Subpart F Income.
- CFC makes a \$10 distribution in 2015.
- The \$100 loan remains outstanding for the entire year.

- In 2015, USP must include \$20 in income as an IRC 956 Inclusion as required by IRC 951(a)(1)(B) and 956. The steps in the example show how to calculate the IRC 956 Inclusion.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 1: Identify US property held or treated as held by the CFC.
 - The \$100 is US property since it is an obligation of a US person and does not fall under an exception to the definition of US property.

 - Step 2: Determine the amount of the US property taken into account on the last day of each of the CFC's quarters. Reduce this amount by the liabilities to which the US property is subject that constitute specific charges.
 - No liability is a specific charge against the \$100 of US property.
 - End of quarter loan balances:

Q1 (March 31st)	\$100
Q2 (June 30th)	\$100
Q3 (September 30th)	\$100
Q4 (December 31st)	\$100
- (Note: Example assumes no increase in US property due to unpaid, accrued interest)

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 3: Add the four quarter-end balances together and divide by four to get the quarterly average and determine the US shareholder's pro rata share of that amount.

	Q1	Q2	Q3	Q4	Sum of Quarterly Balances	Sum Divided By Four
Quarter-End Balance	\$100	\$100	\$100	\$100	\$400	\$100

- Because USP owns 100% of CFC, USP's pro rata share is \$100.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 4: Determine the amounts and categories of current and accumulated E&P. These amounts are determined before taking current year distributions into account.

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
Accumulated BOY E&P	\$50	\$0	\$10	\$60
Current Year E&P	\$0	\$20	\$10	\$30
Current and Accumulated E&P	\$50	\$20	\$20	\$90

- Year 2 Accumulated BOY E&P is equal to the Year 1 E&P Year-End Balance.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 5: Determine the amount of actual current year distributions.
\$10 distribution which will be from 959(c)(1) E&P under the IRC 959(c) ordering rules.

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
Current and Accumulated E&P	\$50	\$20	\$20	\$90
Distributions	(\$10)	\$0	\$0	(\$10)
E&P Before 956 Calculation	\$40	\$20	\$20	\$80

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 6: Use the information in the above steps to calculate the Adjusted US Property.

Adjusted US Property	
US shareholder's pro rata share of the Quarterly Average	\$100
Less accumulated BOY 959(c)(1) E&P with respect to the US shareholder reduced (but not below 0) by distributions of 959(c)(1) E&P that affect the shareholder's 959(c)(1) E&P account	(\$40)
Adjusted US Property	\$60

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 7: Use the information in the above steps to calculate US shareholder's pro rata share of Applicable Earnings.

Applicable Earnings	
Current Year E&P	\$30
Plus positive accumulated BOY E&P	60
Less distributions	(\$10)
Less accumulated BOY 959(c)(1) E&P with respect to the US shareholder reduced (but not below 0) by distributions of 959(c)(1) E&P	(\$40)
Applicable Earnings	\$40

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 8: IRC 956 Amount: Lesser of Adjusted US Property or US shareholder's pro rata share of Applicable Earnings.

IRC 956 Amount	
Adjusted US Property	\$60
Applicable Earnings	\$40
IRC 956 Amount: The lesser of the two numbers above	\$40

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

Step 9: Determine the IRC 956 Inclusion. Make all required adjustments to IRC 959(c) categories of E&P.

IRC 956 Inclusion	
IRC 956 Amount	\$40
Less undistributed, accumulated BOY 959(c)(2) E&P	0
Less undistributed, current year 959(c)(2) E&P	(\$20)
IRC 956 Inclusion	\$20

- Recall that CFC started the year with \$0 of 959(c)(2) E&P and had \$20 of Subpart F Income during 2015. The Subpart F Income inclusion by USP increased 959(c)(2) E&P to \$20.
- Since the IRC 956 Amount was reduced by \$20 in this step (from \$40 to \$20) to get the IRC 956 Inclusion, \$20 of E&P will be reclassified from 959(c)(2) E&P to 959(c)(1) E&P.
- Also, since the IRC 956 Inclusion is \$20, \$20 of E&P will be reclassified from 959(c)(3) E&P to 959(c)(1) E&P.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 9 (cont'd)

- Year-end E&P is calculated as follows:

	959(c)(1) E&P	959(c)(2) E&P	959(c)(3) E&P	Total E&P
E&P Before 956 Calculation	\$40	\$20	\$20	\$80
Reclassification Under IRC 959(a)(2)	\$20	(\$20)		
Current 956 Inclusion	\$20		(\$20)	
Year-End Balance	\$80	\$0	\$0	\$80

- E&P Before 956 Calculation was calculated in Step 5 and is the sum of (i) accumulated BOY E&P and (ii) current year E&P less distributions made during the tax year.

Example of the Process (cont'd)

Calculation of the IRC 956 Inclusion

Example: Year 2 (cont'd)

- Step 10: If the amount determined in Step 9 is in a currency other than the US dollar, translate that amount to US dollars using the spot rate on the last day of the CFC's taxable year for which such amount is included.
 - Because the functional currency of the CFC is the US dollar, the entire calculation is done in US dollars. No translation is necessary.

Other Considerations / Impact to Audit

Calculation of the IRC 956 Inclusion	
Considerations	Resources
<ul style="list-style-type: none"> ▪ An examiner should consider the CFC's tax pool when deciding whether to pursue an IRC 956 issue. An IRC 956 Inclusion will bring with it FTCs. These FTCs may minimize or eliminate the tax effect of an income adjustment resulting from an IRC 956 Inclusion. 	<ul style="list-style-type: none"> ▪ IRC 960(a) ▪ IRC 960(c)
<ul style="list-style-type: none"> ▪ A distribution of 959(c)(1) E&P may give rise to a current year 956 Inclusion. When calculating Adjusted US property and Applicable Earnings, 959(c)(1) E&P is subtracted so a distribution may lead to higher respective amounts and an IRC 956 Inclusion. Distributions of 959(c)(1) E&P could also lead to an IRC 956 Inclusion with respect to US property that continues to be held even though there was an IRC 956 Inclusion in a prior year. ▪ For example, in 2013, a wholly owned CFC, with a \$300 of Applicable Earnings and no 959(c)(1) E&P, acquires \$100 of US property on January 1st and holds it throughout this example. <ul style="list-style-type: none"> – In 2013, the US shareholder would have a \$100 IRC 956 Inclusion. – In 2014, the CFC has \$100 in 959(c)(1) E&P. There would not be an IRC 956 Inclusion in this year because Adjusted US property is \$0. – In 2015, assume the CFC distributes all of its 959(c)(1) E&P, but still has \$300 of Applicable Earnings. The distribution causes Adjusted US Property to increase to \$100 and the US shareholder would have a \$100 IRC 956 Inclusion. 	
<ul style="list-style-type: none"> ▪ There are many exceptions to the IRC 956 definition of US property. If an item of property appears to qualify as US property, but a taxpayer has not treated it as such, a good first step is to ask the taxpayer if you understand the facts correctly and what, if any, exception applies. 	

Index of Referenced Resources

Calculation of the IRC 956 Inclusion
IRC 951
IRC 956
IRC 959
Treas. Reg. 1.956-1(e)
Treas. Reg. 1.956-2
Treas. Reg. 1.956-3
Treas. Reg. 1.956-4
Prop. Treas. Reg. 1.959-3

Training and Additional Resources

Calculation of the IRC 956 Inclusion	
Type of Resource	Description(s)
SABA Sessions	<ul style="list-style-type: none"> ▪ FY2013 IBC CPE: IRC 956 & Other Repatriation Strategies, p. 28-40
Issue Toolkits	<ul style="list-style-type: none"> ▪ IRC 956 Calculator (currently being developed)
White Papers / Guidance	<ul style="list-style-type: none"> ▪ IRM 4.61.7.34 to 4.61.7.44
Reference Materials – Treaties	<ul style="list-style-type: none"> ▪ BNA Tax Management Int'l Portfolio 930-2nd Sec. II (Exclusion from Gross Income of Previously Taxed Earnings and Profits) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIII (Calculation of Amount of U.S. Property Held by the CFC) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XIV (Calculations of Amount of IRC 951(a)(1)(B) Gross Income) ▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XV (Effect of Distributions to Shareholders on IRC 956 Calculations)

Training and Additional Resources (cont'd)

Calculation of the IRC 956 Inclusion	
Type of Resource	Description(s)
Reference Materials – Treaties (cont'd)	<ul style="list-style-type: none">▪ BNA Tax Management Int'l Portfolio 6260-1st Sec. XVI (Adjusted Tax Basis, Earnings and Profits, and Foreign Tax Credit Considerations)▪ BNA Tax Management Int'l Portfolio 6260-1st Worksheet 6 (S. Rep. No. 103-36, at 319–21, 323–24, 327–38, 343 (1993))▪ Bittker & Lokken, Fed Taxation of Income, Estates and Gifts<ul style="list-style-type: none">- ¶69.11.1 Earnings Invested in U.S. Property- ¶69.12.2 Allocations of Subpart F Income Among Shareholders

Glossary of Terms and Acronyms

Term/Acronym	Definition
959(c)(1) E&P	E&P described in IRC 959(c)(1) – includes undistributed E&P previously included in income pursuant to IRC 951(a)(1)(B) and IRC 956 as well as former IRC 956A
959(c)(2) E&P	E&P described in IRC 959(c)(2) – includes undistributed E&P previously included in income pursuant to IRC 951(a)(1)(A) (a Subpart F Income inclusion)
959(c)(3) E&P	E&P described in IRC 959(c)(3) – all other E&P
Adjusted US property	The amount referred to in IRC 956(a)(1). This term is not in the IRC or Treas. Regs., but was coined for this Process Unit.
Applicable Earnings	Applicable earnings as defined in IRC 956(b)(1) - includes the sum of positive accumulated BOY E&P and current E&P reduced by distributions made during the taxable year and further reduced by 959(c)(1) E&P.
BOY	Beginning of year
CFC	Controlled foreign corporation as defined in IRC 957
E&P	Earnings and profits
FTC	Foreign tax credit
IP	Intellectual property
IRC 956 Amount	The amount described in IRC 956(a) - the lesser of Adjusted US Property and the US shareholder's pro rata share of Applicable Earnings.

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
IRC 956 Inclusion	The amount required to be included in income pursuant to IRC 951(a)(1)(B) - the IRC 956 Amount reduced by the sum of the accumulated BOY 959(c)(2) E&P and the current year 959(c)(2) E&P with respect to the US shareholder.
PTI	Previously taxed income
Subpart F Income	Income of a CFC described in IRC 952(a)
USP	United States Parent
US person	United States person as defined in IRC 957(c)
US property	Defined in IRC 956(c)
US shareholder	United States shareholder as defined in IRC 951(b)

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9414.01-01	Short Term Loan Exclusion from United States Property	RPA/T/04_01_01_01-01 (formerly RPA/9414.01_01(2015))