Reg. 1.986(a)-1(a)(2)(iv)(D), Example

Corp. Elects To Use The Spot Rate To Translate Non-Functional Currency Taxes of Dollar QBUs

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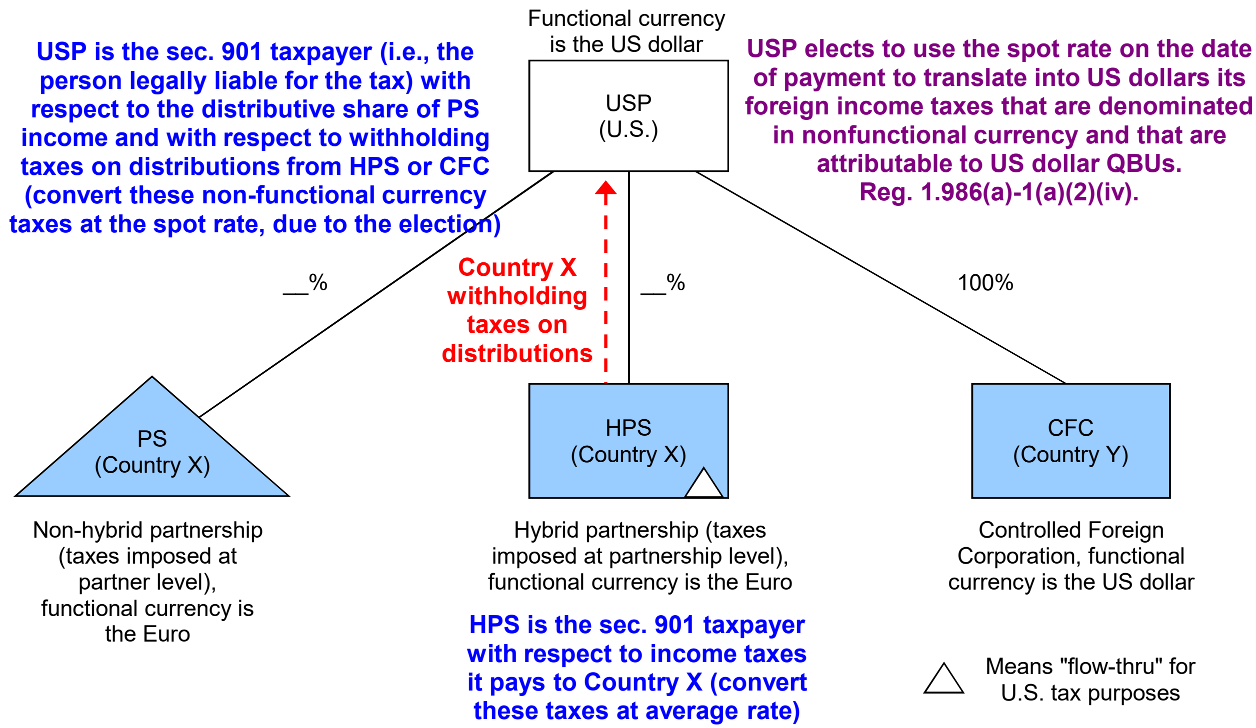
(1) Facts. USP, a domestic corporation that uses the calendar year as its taxable year, owns a partnership interest in PS, a non-hybrid partnership organized in Country X. USP also owns an equity interest in HPS, a Country X corporation that has filed an entity classification election ("check the box" election) under Reg. 301.7701-3 to be treated as a partnership for Federal income tax purposes. USP also owns 100% of CFC, a Country Y controlled foreign corporation that uses the U.S. dollar as its functional currency. PS and HPS each use a fiscal year ending November 30 as its taxable year both for Federal income tax purposes and for Country X tax purposes, and their functional currency is the Euro. HPS is the section 901 taxpayer of foreign income taxes denominated in Euros that it pays to Country X and properly records on its books and records.



USP takes its distributive share of the HPS taxes into account under sections 702(a)(6) and 901(b)(5) and Reg.s 1.702-1(a)(6) and 1.704-1(b)(4)(viii) in computing its foreign tax credit. USP is the section 901 taxpayer of Euro-denominated foreign income taxes it pays to Country X with respect to its distributive share of the income of PS, and also pays Country X taxes withheld in Euros from distributions from HPS to USP and properly records these taxes on its books and records. Pursuant to Reg. 1.985-1(b)(1)(iii), USP's functional currency is the dollar. USP timely elects under Reg. 1.986(a)-1(a)(2)(iv) to use the spot rate on the date of payment to translate into dollars its foreign income taxes denominated in nonfunctional currency that are attributable to all QBUs with dollar functional currencies.

(2) Result. The Euro taxes paid by USP with respect to its distributive share of income from PS and the Euro taxes withheld from distributions from HPS are nonfunctional currency taxes attributable to USP, a QBU with a dollar functional currency. Accordingly, these taxes are translated into dollars at the spot rate on the date the taxes are paid. USP's distributive share of the Euro taxes paid by HPS are attributable to HPS, a Euro functional currency QBU of USP. Because these taxes are not attributable to a dollar QBU of USP, they are not covered by USP's election and so are translated into dollars at the average exchange rate for HPS's U.S. taxable year ending on November 30. See Reg. 1.986(a)-1(a)(1). Foreign income taxes paid by CFC are not covered by USP's election; however, if USP so chooses it may make a separate election on behalf of CFC to use the spot rate on the date of payment to translate either all of CFC's nonfunctional currency taxes, or only those taxes that are attributable to CFC's dollar QBUs (which includes CFC). If instead USP had elected to use the spot rate on the date of payment to translate all of its foreign income taxes denominated in nonfunctional currency, rather than only those taxes attributable to QBUs with dollar functional currencies, then the spot rate on the date of payment would apply to translate all of the Euro taxes paid or accrued by USP, including its distributive share of taxes paid by HPS. However, this election would still not apply to taxes paid or accrued by CFC. See Reg. 1.986(a)-1(a)(2)(iv)(B).

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