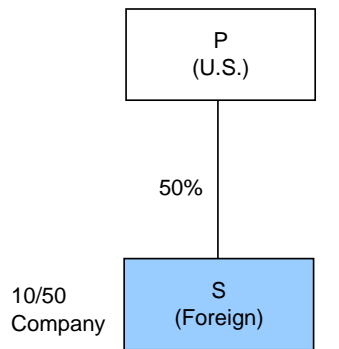


Temp. Reg. 1.904-7T(f)(iv), Example 1

Copyright © 2006 Andrew Mitchel LLC
International Tax Services
www.andrewmitchel.com

Commissioner's Reconstruction of 10/50 Corporation's Historical Earnings & Taxes

January 1, 1987 to Dec. 31, 2002



10/50 Pool E&P = 200
10/50 Pool Taxes = 100

The Commissioner determines that half of the E&P is passive & half is general limitation, and that all of the taxes are general limitation.

Prior to the Taxpayer Relief Act of 1997 dividends from each 10/50 corporation were subject to a separate foreign tax credit limitation. The 1997 Act modified these rules, effective for taxable years beginning after December 31, 2002. The 1997 Act provided that 10/50 dividends out of pre-2003 earnings would be included in a single separate category and 10/50 dividends out of post-2002 earnings would receive look-thru treatment.

The American Jobs Creation Act of 2004 ("AJCA") modified the 10/50 dividend rules and provided that dividends from 10/50 corporations would be eligible for look-thru treatment effective for taxable years beginning after December 31, 2002, without regard to when the distributed earnings were accumulated.

If the look-thru treatment of a dividend out of earnings formerly accumulated in the non-look-thru pool has not been adequately substantiated, the dividend is treated as passive. To substantiate the look-thru characterization of the earnings and taxes in the non-look-thru pools, the taxpayer must reconstruct the non-look-thru pools of earnings and taxes for each year in the non-look-thru period.

Due to potential difficulties in reconstructing historical accumulated earnings and taxes accounts of a 10/50 corporation on a look-thru basis, a safe harbor allows a taxpayer to allocate the earnings and taxes in the non-look-thru pools ratably to the look-thru pools on the first day of the 10/50 corporation's first post-2002 taxable year in the same percentages as the taxpayer (or the qualified group member that owns the 10/50 corporation) properly characterizes the stock of the 10/50 corporation in the separate categories for purposes of apportioning the taxpayer's interest expense in its first taxable year ending after the first day of the 10/50 corporation's first post-2002 taxable year.

P, a domestic corporation, has owned 50% of the voting stock of S, a foreign corporation, at all times since January 1, 1987, and S has been a noncontrolled section 902 corporation (also known as a "10/50 corporation") with respect to P since that date. 1987 was the first year in which post-1986 undistributed earnings were accumulated in the non-look-thru pool of S. As of December 31, 2002, S had 200u of post-1986 undistributed earnings and \$100 of post-1986 foreign income taxes in its non-look-thru pools. P does not elect the safe harbor method to allocate the earnings and taxes in the non-look-thru pools and does not attempt to substantiate the look-thru characterization of S's non-look-thru pools. The Commissioner, however, reasonably determines, based on information used to characterize S's stock for purposes of apportioning P's interest expense in P's 2003 and 2004 taxable years, that 100u of the earnings and all \$100 of the taxes in the non-look-thru pools are properly assigned on a look-thru basis to the general limitation category, and 100u of earnings and no taxes are properly assigned on a look-thru basis to the passive category. Therefore, in accordance with the Commissioner's look-thru characterization of the earnings and taxes in S's non-look-thru pools, on January 1, 2003, S has 100u of post-1986 undistributed earnings and \$100 of post-1986 foreign income taxes in the general limitation category and 100u of post-1986 undistributed earnings and no post-1986 foreign income taxes in the passive category.

[HUNDREDS of additional charts at www.andrewmitchel.com](http://www.andrewmitchel.com)