

\$200,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1954, is owned on that date by persons resident in Formosa, Hong Kong, the United States, or possessions of the United States, or individual citizens of the United States. It distributes a special dividend amounting to \$100,000 on February 15, 1955, which is certified by the Secretary of Commerce as provided in section 941(b). For the purpose of the tax imposed by section 11, it is necessary in this example to make two computations, first, without allowing the special deduction from taxable income on account of income derived from sources within Formosa and Hong Kong, and, second, allowing such deduction. The computations are as follows:

(2) First computation; without allowing the special deduction from taxable income.

Taxable income	\$200,000
Normal tax (section 11 (b))	60,000
Surtax (section 11 (c))	38,500
Total income tax	98,500

(3) Second computation; allowing the special deduction from taxable income.

Taxable income	\$200,000
----------------------	-----------

Since the total taxable income is derived from sources within Formosa and Hong Kong and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (a) persons resident in Formosa, Hong Kong, the United States, or possessions of the United States, and (b) individual citizens of the United States wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of such taxable income is deductible.

Special deduction from taxable income	\$200,000
Amount of income subject to tax under section 11	None

(4) Since the special dividend (\$100,000) exceeds the diminution of the tax (\$98,500) on account of the allowance of the special deduction from taxable income, the entire amount of the special deduction is allowable and the corporation has no income tax liability for 1954.

§ 1.943-1 Withholding by a China Trade Act corporation.

Dividends paid by a China Trade Act corporation to a nonresident alien individual, foreign partnership, or foreign corporation are subject to withholding of tax at source under § 1.1441-1. However, see paragraph (c) of § 1.1441-4 for exemption applicable to dividends paid to residents of Formosa or Hong Kong.

[T.D. 6908, 31 FR 16769, Dec. 31, 1966]

CONTROLLED FOREIGN CORPORATIONS

§ 1.951-1 Amounts included in gross income of United States shareholders.

(a) *In general.* If a foreign corporation is a controlled foreign corporation (within the meaning of section 957) for an uninterrupted period of 30 days or more (determined under paragraph (f) of this section) during any taxable year of such corporation beginning after December 31, 1962, every person—

(1) Who is a United States shareholder (as defined in section 951(b) and paragraph (g) of this section) of such corporation at any time during such taxable year, and

(2) Who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income for his taxable year in which or with which such taxable year of the corporation ends, the sum of—

(i) Except as provided in section 963, such shareholder's pro rata share (determined under paragraph (b) of this section) of the corporation's subpart F income (as defined in section 952) for such taxable year of the corporation,

(ii) Such shareholder's pro rata share (determined under paragraph (c)(1) of this section) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such taxable year of the corporation,

(iii) Such shareholder's pro rata share (determined under paragraph (c)(2) of this section) of the corporation's previously excluded subpart F income withdrawn from investment in foreign base company shipping operations for such taxable year of the corporation, and

(iv) Such shareholder's pro rata share (determined under paragraph (d) of this section) of the corporation's increase in earnings invested in United States property for such taxable year of the corporation (but only to the extent such pro rata share is not excluded from such shareholder's gross income for his taxable year under section 959(a)(2)).

For purposes of determining whether a United States shareholder which is a domestic corporation is a personal

holding company under section 542 and §1.542-1, the character of the amount includible in gross income of such domestic corporation under this paragraph shall be determined as if such amount were realized directly by such corporation from the source from which it is realized by the controlled foreign corporation. See paragraph (a) of §1.957-2 for special limitation on the amount of subpart F income in the case of a controlled foreign corporation described in section 957(b). See section 970(a) and §1.970-1 which provides for the reduction of subpart F income of export trade corporations.

(b) *Limitation on a United States shareholder's pro rata share of subpart F income*—(1) *In general.* For purposes of paragraph (a)(2)(i) of this section, a United States shareholder's pro rata share (determined in accordance with the rules of paragraph (e) of this section) of the foreign corporation's subpart F income for the taxable year of such corporation is—

(i) The amount which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in such corporation's taxable year, on which such corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount which bears the same ratio to its subpart F income for such taxable year as the part of such year during which such corporation is a controlled foreign corporation bears to the entire taxable year, reduced by—

(ii) The amount of distributions received by any other person during such taxable year as a dividend with respect to such stock, but only to the extent that such distributions do not exceed the dividend which would have been received by such other person if the distributions by such corporation to all its shareholders had been the amount which bears the same ratio to the subpart F income of such corporation for the taxable year as the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire taxable year.

(2) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example 1. A, a United States shareholder, owns 100 percent of the only class of stock of M, a controlled foreign corporation throughout 1963. Both A and M Corporation use the calendar year as a taxable year. For 1963, M Corporation derives \$100 of subpart F income, has \$100 of earnings and profits, and makes no distributions. A must include \$100 in his gross income for 1963 under section 951(a)(1)(A)(i).

Example 2. The facts are the same as in example 1, except that instead of holding 100 percent of the stock of M Corporation for the entire year, A sells 60 percent of such stock to B, a nonresident alien, on May 26, 1963. Thus, M Corporation is a controlled foreign corporation for the period January 1, 1963, through May 26, 1963. A must include \$40 ($\$100 \times 146/365$) in his gross income for 1963 under section 951(a)(1)(A)(i).

Example 3. The facts are the same as in example 1, except that instead of holding 100 percent of the stock of M Corporation for the entire year, A holds 60 percent of such stock on December 31, 1963, having acquired such interest on May 26, 1963, from B, a nonresident alien, who owned such interest from January 1, 1963. Before A's acquisition of such stock, M Corporation had distributed a dividend of \$15 to B in 1963 with respect to such stock. A must include \$21 in his gross income for 1963 under section 951(a)(1)(A)(i), such amount being determined as follows:

Corporation M's Subpart F income for 1963	\$100
Less: Reduction under section 951(a)(2)(A) for period (1-1-63 through 5-26-63) during which M Corporation is not a controlled foreign corporation ($\$100 \times 146/365$)	40
Subpart F income for 1963 as limited by section 951(a)(2)(A)	60
A's pro rata share of subpart F income as determined under section 951(a)(2)(A) (60 percent of \$60)	36
Less: Reduction under section 951(a)(2)(B) for dividends received by B during 1963 with respect to the stock acquired by A in M Corporation:	
(i) Dividend received by B	15
(ii) B's pro rata share of the amount which bears the same ratio to M Corporation's subpart F income for 1963 (\$100) as the period during which A did not own (within the meaning of section 958(a)) his stock (146 days) bears to the entire taxable year (365 days) (60 percent of ($\$100 \times 146/365$))	24
(iii) Amount of reduction (lesser of (i) or (ii))	15
A's pro rata share of Subpart F income as determined under section 951(a)(2)	21

Example 4. A, a United States shareholder, owns 100 percent of the only class of stock of P, a controlled foreign corporation throughout 1963, and P owns 100 percent of the only

class of stock of R, a controlled foreign corporation throughout 1963. A and Corporations P and R each use the calendar year as a taxable year. For 1963, R Corporation derives \$100 of subpart F income, has \$100 of earnings and profits, and distributes a dividend of \$20 to P Corporation. Corporation P has no income for 1963 other than the dividend received from R Corporation. A must include \$100 in his gross income for 1963 under section 951(a)(1)(A)(i) as subpart F income of R Corporation for such year. Such subpart F income is not reduced under section 951(a)(2)(B) for the dividend of \$20 paid to P Corporation because there was no part of the year 1963 during which A did not own (within the meaning of section 958(a)) the stock of R Corporation. By reason of the application of section 959(b), the \$20 distribution from R Corporation to P Corporation is not again includible in the gross income of A under section 951(a).

Example 5. The facts are the same as in example 4, except that instead of holding the stock of R Corporation for the entire year, P Corporation acquires 60 percent of the only class of stock of R Corporation on March 14, 1963, from C, a nonresident alien, after R Corporation distributes in 1963 a dividend of \$35 to C with respect to the stock so acquired by P Corporation. The stock interest so acquired by P Corporation was owned by C from January 1, 1963, until acquired by P Corporation. A must include \$36 in his gross income for 1963 under section 951(a)(1)(A)(i), such amount being determined as follows:

Corporation R's Subpart F income for 1963	\$100
Less: Reduction under section 951(a)(2)(A) for period (1-63 through 3-14-63) during which R Corporation is not a controlled foreign corporation (\$100×73/365)	20
Subpart F income for 1963 as limited by section 951(a)(2)(A)	80
A's pro rata share of subpart F income as determined under section 951 (a)(2)(A) (60 percent of \$80)	48
Less: Reduction under section 951(a)(2)(B) for dividends received by C during 1963 with respect to the stock indirectly acquired by A in R Corporation:	
(i) Dividend received by C	35
(ii) C's pro rata share of the amount which bears the same ratio to R Corporation's Subpart F income for 1963 (\$100) as the period during which A did not indirectly own (within the meaning of section 958(a)(2)) his stock (73 days) bears to the entire taxable year (365 days) (60 percent of (\$100×73/365))	12
(iii) Amount of reduction (lesser of (i) or (ii))	12
A's pro rata share of Subpart F income as determined under section 951 (a)(2)	36

(c) *Limitation on a United States shareholder's pro rata share of previously excluded subpart F income withdrawn from investments—(1) Investments in less developed countries.* For purposes of paragraph (a)(2)(ii) of this section, a United States shareholder's pro rata share (determined in accordance with the rules of paragraph (e) of this section) of the foreign corporation's previously excluded subpart F income withdrawn from investment in less developed countries for the taxable year of such corporation shall not exceed an amount which bears the same ratio to such shareholder's pro rata share of such income withdrawn (as determined under section 955(a)(3), as in effect before the enactment of the Tax Reduction Act of 1975, and paragraph (c) of §1.955-1) for such taxable year as the part of such year during which such corporation is a controlled foreign corporation bears to the entire taxable year. See paragraph (c)(2) of §1.955-1 for a special rule applicable to exclusions and withdrawals occurring before the date on which the United States shareholder acquires his stock.

(2) *Investments in foreign base company shipping operations.* For purposes of paragraph (a)(2)(iii) of this section, a United States shareholder's pro rata share (determined in accordance with the rules of paragraph (e) of this section) of the foreign corporation's previously excluded subpart F income withdrawn from investment in foreign base company shipping operations for the taxable year of such corporation shall not exceed an amount which bears the same ratio to such shareholder's pro rata share of such income withdrawn (as determined under section 955(a)(3) and paragraph (c) of §1.955A-1) for such taxable year as the part of such year during which such corporation is a controlled foreign corporation bears to the entire taxable year. See paragraph (c)(2) of §1.955A-1 for a special rule applicable to exclusions and withdrawals occurring before the date on which the United States shareholder acquires his stock.

(d) *Limitation on a United States shareholder's pro rata share of increase in investment in United States property.* For purposes of paragraph (a)(2)(iv) of this section, a United States shareholder's

pro rata share (determined in accordance with the rules of paragraph (e) of this section) of the foreign corporation's increase in earnings invested in United States property for the taxable year of such corporation shall not exceed an amount which bears the same ratio to such shareholder's pro rata share of such increase (as determined under section 956(a)(2) and paragraph (c) of § 1.956-1) for such taxable year as the part of such year during which such corporation is a controlled foreign corporation bears to the entire taxable year. The amount determined under the preceding sentence, however, shall be taken into account under paragraph (a)(2)(iv) of this section only to the extent such amount is not excluded from such shareholder's gross income for his taxable year under section 959(a)(2) and the regulations thereunder.

(e) "*Pro rata share*" defined—(1) *In general.* For purposes of paragraphs (b), (c), and (d) of this section, a United States shareholder's pro rata share of a controlled foreign corporation's subpart F income, previously excluded subpart F income withdrawn from investment in less developed countries, previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, or increase in earnings invested in United States property, respectively, for any taxable year is his pro rata share determined under paragraph (a) of § 1.952-1, paragraph (c) of § 1.955-1, paragraph (c) of § 1.955A-1, or paragraph (c) of § 1.956-1, respectively.

(2) *More than one class of stock.* If a controlled foreign corporation for a taxable year has more than one class of stock outstanding, the amount of such corporation's subpart F income, withdrawal, or increase in investment, for the taxable year which shall be taken into account with respect to any one class of such stock for purposes of subparagraph (1) of this paragraph shall be that amount which bears the same ratio to the total of such subpart F income, withdrawal, or increase in investment for such year as the earnings and profits which would be distributed with respect to such class of stock if all earnings and profits of such corporation for such year were distributed on the last day of such corporation's

taxable year on which such corporation is a controlled foreign corporation bear to the total earnings and profits of such corporation for such taxable year. For purposes of the preceding sentence, if an arrearage in dividends for prior taxable years exists with respect to a class of preferred stock of such corporation, the earnings and profits for the taxable year shall be attributed to such arrearage only to the extent such arrearage exceeds the earnings and profits of such corporation remaining from prior taxable years beginning after December 31, 1962.

(3) *Discretionary power to allocate earnings to different classes of stock.* If the allocation of a foreign corporation's earnings and profits for the taxable year between two or more classes of stock depends upon the exercise of discretion by that body of persons which exercises with respect to such corporation the powers ordinarily exercised by the board of directors of a domestic corporation, the allocation of earnings and profits to such classes shall be made for purposes of this paragraph as if such classes constituted one class of stock in which each share has the same rights to dividends as any other share, unless a different method of allocation of earnings and profits is established as proper by the United States shareholder.

(4) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example 1. Throughout its taxable year 1964, controlled foreign corporation A has outstanding 40 shares of common stock and 60 shares of 6-percent, nonparticipating, non-voting, preferred stock with a par value of \$100 per share. D, a United States citizen who uses the calendar year as a taxable year, owns 30 shares of the common, and 15 shares of the preferred, stock during 1964: Corporation A for 1964 has earnings and profits of \$1,000, and income of \$500 with respect to which amounts are required to be included in gross income of United States shareholders under section 951(a). In such case, if the total \$1,000 of earnings and profits were distributed on December 31, 1964, \$360 ($0.06 \times \100×60) would be distributed with respect to A Corporation's preferred stock and \$640 ($\$1,000$ minus \$360) would be distributed with respect to its common stock. Accordingly, of the \$500 with respect to which amounts are required to be included in gross income of United States shareholders under section

951(a), \$180 ($\$360/\$1,000 \times \500) is allocated to the outstanding preferred stock and \$320 ($\$640/\$1,000 \times \500) is allocated to the outstanding common stock. D's pro rata share of such amounts for 1964 is \$285 [$(\$180 \times 15/60) + (\$320 \times 30/40)$].

Example 2. The facts are the same as in example 1, except that the preferred stock is cumulative and there is an arrearage in dividends with respect to such stock of \$900; on December 31, 1963, Corporation A has accumulated earnings and profits for 1963 of \$700; therefore, for purposes of this paragraph, Corporation A's earnings and profits for 1964 attributable to such arrearage may not exceed \$200 (\$900 minus \$700). In such case, for purposes of this paragraph, if the \$1,000 earnings and profits for 1964 were distributed on December 31, 1964, \$560 [$(0.06 \times \$100 \times 60) + \200] would be distributed with respect to A Corporation's preferred stock and \$440 ($\$1,000$ minus \$560) would be distributed with respect to its common stock. Accordingly, of the \$500 with respect to which amounts are required to be included in gross income of United States shareholders under section 951(a), \$280 ($\$560/\$1,000 \times \500) is allocated to the outstanding preferred stock and \$220 ($\$440/\$1,000 \times \500) is allocated to the outstanding common stock. D's pro rata share of such amounts for 1964 is \$235 [$(\$280 \times 15/60) + (\$220 \times 30/40)$].

(f) *Determination of holding period.* For purposes of sections 951 through 964, the holding period of an asset (including stock of a controlled foreign corporation) shall be determined by excluding the day on which such asset is acquired and including the day on which such asset is disposed of. The application of this paragraph may be illustrated by the following example:

Example. On June 30, 1963, United States person E acquires 70 of the 100 shares of the only class of stock of foreign corporation A from nonresident alien B, who until such time owns all such 100 shares. E sells 10 shares of stock of such corporation on November 30, 1963, and 60 shares on December 31, 1963, to nonresident alien F. Corporation A is a controlled foreign corporation for the period beginning with July 1, 1963, and extending through December 31, 1963. As to the 10 shares of stock sold on November 30, 1963, E is treated as not owning such shares at any time after November 30, 1963, nor before July 1, 1963. As to the remaining 60 shares of stock, E is treated as not owning them before July 1, 1963, or after December 31, 1963.

(g) *United States shareholder defined—*
(1) *In general.* For purposes of sections 951 through 964, the term "United States shareholder" means, with re-

spect to a foreign corporation, a United States person (as defined in section 957(d)) who owns within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

(2) *Percentage of total combined voting power owned by United States person—*(i) *Meaning of combined voting power.* In determining for purposes of subparagraph (1) of this paragraph whether a United States person owns the requisite percentage of voting power of all classes of stock entitled to vote, consideration will be given to all the facts and circumstances in each case. In any case where—

(a) A foreign corporation has more than one class of stock outstanding, and

(b) One or more United States persons own (within the meaning of section 958) shares of any one class of stock which possesses the power to elect, appoint, or replace a person, or persons, who with respect to such corporation, exercise the powers ordinarily exercised by a member of the board of directors of a domestic corporation,

the percentage of the total combined voting power with respect to such corporation owned by any such United States person shall be his proportionate share of the percentage of the persons exercising the powers ordinarily exercised by members of the board of directors of a domestic corporation (described in (b) of this subdivision) which such class of stock (as a class) possesses the power to elect, appoint, or replace. In all cases, however, a United States person will be deemed to own 10 percent or more of the total combined voting power with respect to a foreign corporation if such person owns (within the meaning of section 958) 20 percent or more of the total number of shares of a class of stock of such corporation possessing one or more powers enumerated in paragraph (b)(1) of § 1.957-1. Whether a

foreign corporation is a controlled foreign corporation for purposes of sections 951 through 964 shall be determined by applying the rules of section 957 and §§ 1.957-1 through 1.957-4.

(ii) *Illustration.* The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation S has two classes of capital stock outstanding, consisting of 60 shares of class A stock and 40 shares of class B stock. Each class of the outstanding stock is entitled to participate on a share for share basis in any dividend distributions by S Corporation. The owners of a majority of the class A stock are entitled to elect 7 of the 10 corporate directors, and the owners of a majority of the class B stock are entitled to elect the other 3 of the 10 directors. Thus, the class A stock (as a class) possesses 70 percent of the total combined voting power of all classes of stock entitled to vote of S Corporation, and the class B stock (as a class) possesses 30 percent of such voting power. D, a United States person, owns 31 shares of the class A stock and thus owns 36.167 percent ($31/60 \times 70$ percent) of the total combined voting power of all classes of stock entitled to vote of S Corporation. By reason of the ownership of such voting power, D is a United States shareholder of S Corporation under section 951(b). For purposes of section 957, S Corporation is a controlled foreign corporation by reason of D's ownership of a majority of the class A stock, as illustrated in example 2 of paragraph (c) of § 1.957-1. E, a United States person, owns eight shares of the class A stock and thus owns 9.333 percent ($8/60 \times 70$ percent) of the total combined voting power of all classes of stock entitled to vote of S Corporation. Since E owns only 9.333 percent of such voting power and less than 20 percent of the number of shares of the class A stock, he is not a United States shareholder of S Corporation under section 951(b). F, a United States person, owns 14 shares of the class B stock and thus owns 10.5 percent ($14/40 \times 30$ percent) of the total combined voting power of all classes of stock entitled to vote of S Corporation. By reason of the ownership of such voting power, F is a United States shareholder of S Corporation under section 951(b).

Example 2. Foreign corporation R has three classes of stock outstanding, consisting of 10 shares of class A stock, 20 shares of class B stock, and 300 shares of class C stock. Each class of the outstanding stock is entitled to participate on a share for share basis in any distribution by R Corporation. The owners of a majority of the class A stock are entitled to elect 6 of the 10 corporate directors, and the owners of a majority of the class B stock are entitled to elect the other 4 of the 10 di-

rectors. The class C stock is not entitled to vote. D, E, and F, United States persons, each own 2 shares of the class A stock and 100 shares of the class C stock. As owners of a majority of the class A stock, D, E, and F elect 6 members of the board of directors. D, E, and F are United States shareholders of R Corporation under section 951(b) since each owns 20 percent of the total number of shares of the class A stock which possesses the power to elect a majority of the board of directors of R Corporation. For purposes of section 957, R Corporation is a controlled foreign corporation by reason of the ownership by D, E, and F of a majority of the class A stock, as illustrated in example 2 of paragraph (c) of § 1.957-1.

[T.D. 6795, 30 FR 935, Jan. 29, 1965, as amended by T.D. 7893, 48 FR 22507, May 19, 1983]

§ 1.951-2 Coordination of subpart F with election of a foreign investment company to distribute income.

A United States shareholder who for his taxable year is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247(a) and the regulations thereunder is in effect for the taxable year of such company which ends with or within such taxable year of such shareholder shall not be required to include any amount in his gross income for his taxable year under paragraph (a) of § 1.951-1 with respect to such company for that taxable year of such company.

[T.D. 6795, 30 FR 937, Jan. 29, 1965]

§ 1.951-3 Coordination of subpart F with foreign personal holding company provisions.

A United States shareholder (as defined in section 951(b)) who is required under section 551(b) to include in his gross income for his taxable year his share of the undistributed foreign personal holding company income for the taxable year of a foreign personal holding company (as defined in section 552) which for that taxable year is a controlled foreign corporation (as defined in section 957) shall not be required to include in his gross income for his taxable year under section 951(a) and paragraph (a) of § 1.951-1 any amount attributable to the earnings and profits of such corporation for that taxable year of such corporation. If a foreign corporation is both a foreign personal