§ 1.957–1 Definition of controlled foreign corporation.

(a) In general. The term controlled foreign corporation means any foreign corporation of which more than 50 percent (or such lesser amount as is provided in section 957(b) or section 953(c)) of either—

(1) The total combined voting power of all classes of stock of the corporation entitled to vote; or

(2) The total value of the stock of the corporation, is owned within the meaning of section 958(a), or (except for purposes of section 953(c)) is considered as owned by applying the rules of section 958(b) and § 1.958–2, by United States shareholders on any day during the taxable year of such foreign corporation. For the definition of the term United States shareholder, see sections 951(b) and 953(c)(1)(A). For the definition of the term foreign corporation, see § 301.7701–5 of this chapter (Procedure and Administration Regulations). For the treatment of associations as corporations, see section 7701(a)(3) and §§ 301.7701–1 and 301.7701–2 of this chapter. For the definition of the term stock, see sections 958(a)(3) and 7701(a)(7). For the classification of a member in an association, joint stock company or insurance company as a shareholder, see section 7701(a)(8).

(b) Percentage of total combined voting power owned by United States shareholders—(1) Meaning of combined voting power. In determining for purposes of paragraph (a) of this section whether United States shareholders own the requisite percentage of total combined voting power of all classes of stock entitled to vote, consideration will be given to all the facts and circumstances of each case. In all cases, however, United States shareholders of a foreign corporation will be deemed to own the requisite percentage of total combined voting power of all classes of stock entitled to vote if they have the power to elect, appoint, or replace a majority of that body of persons exercising, with respect to such corporation, the powers ordinarily exercised by the board of directors of a domestic corporation—

(i) If they have the power to elect, appoint, or replace a majority of that body of persons exercising, with respect to such corporation, the powers ordinarily exercised by the board of directors of a domestic corporation;

(ii) If any person or persons elected or designated by such shareholders have the power, where such shareholders have the power to elect exactly one-half of the members of such governing body of such foreign corporation, either to cast a vote deciding an evenly divided vote of such body or, for the duration of any deadlock which may arise, to exercise the powers ordinarily exercised by such governing body; or

(iii) If the powers which would ordinarily be exercised by the board of directors of a domestic corporation are exercised with respect to such foreign corporation by a person whom such shareholders have the power to elect, appoint, or replace.

(2) Shifting of formal voting power. Any arrangement to shift formal voting power away from United States shareholders of a foreign corporation will not be given effect if in reality voting power is retained. The mere ownership of stock entitled to vote does not by itself mean that the shareholder owning such stock has the voting power of such stock for purposes of section 957. For example, if there is any agreement, whether express or implied, that any shareholder will not vote his stock or will vote it only in a specified manner, or that shareholders owning stock having not more than 50 percent of the total combined voting power will exercise voting power normally possessed by a majority of stockholders, then the nominal ownership of the voting power will be disregarded in determining which shareholders actually hold such voting power, and this determination will be made on the basis of such agreement. Moreover, where United States shareholders own shares of one or more classes of stock of a foreign corporation which has another class of stock outstanding, the voting power ostensibly provided such other class of stock will be deemed owned by any person or persons on whose behalf it is exercised or, if not exercised, will be disregarded if the percentage of voting power of such other class of stock is substantially greater than its proportionate share of the corporate earnings, if the facts indicate that the shareholders of such other class of stock do not exercise their voting rights independently or fail to exercise such voting rights,
and if a principal purpose of the arrangement is to avoid the classification of such foreign corporation as a controlled foreign corporation under section 957.

(c) Illustrations. The application of this section may be illustrated by the following examples:

Example 1. Foreign corporation R has two classes of capital stock outstanding, 60 shares of class A stock, and 40 shares of class B stock. Each share of each class of stock has one vote for all purposes. E, a United States person, owns 51 shares of class A stock. Corporation R is a controlled foreign corporation.

Example 2. Foreign corporation S has three classes of capital stock outstanding, consisting of 60 shares of class A stock, 40 shares of class B stock, and 200 shares of class C stock. The owners of a majority of 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 directors. Class C stock has no voting rights. D, a United States person, owns all of the shares of the class C stock. He also owns 31 shares of class A stock and as such an owner can elect 6 members of the board of directors. None of the remaining shares of class A stock, or the 40 shares of class B stock, is owned, or considered as owned, within the meaning of section 958, by a United States person. Since, as owner of 31 shares of the class A stock, D has sufficient voting power 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 directors. Corporation S is a controlled foreign corporation.

Example 3. M, a United States person, owns a 51-percent interest in R Company, a foreign company of which he is a member. The company, if it were domestic, would be taxable as a corporation. Company S is formed under the laws of foreign country Y. The remaining interest of 51 percent in S Company is owned by persons who are not United States persons. The organization contract of S Company provides for one manager, B, a citizen and resident of country Y who is an officer of M Corporation in charge of its foreign operations in such country, or any person M Corporation may at any time appoint to succeed B in such capacity. The manager has the sole authority with respect to S Company to exercise powers ordinarily exercised by a board of directors of a domestic corporation. Since M Corporation has the discretionary power to replace B and to appoint his successor as manager of S Company, the company is a controlled foreign corporation.

Example 4. Domestic corporation M owns a 49-percent interest in S Company, a foreign company of which it is a member. The company, if it were domestic, would be taxable as a corporation. Company S is formed under the laws of foreign country Y. The remaining interest of 51 percent in S Company is owned by persons who are not United States persons. The organization contract of S Company provides for one manager, B, a citizen and resident of country Y who is an officer of M Corporation in charge of its foreign operations in such country, or any person M Corporation may at any time appoint to succeed B in such capacity. The manager has the sole authority with respect to S Company to exercise powers ordinarily exercised by a board of directors of a domestic corporation. Since M Corporation has the discretionary power to replace B and to appoint his successor as manager of S Company, the company is a controlled foreign corporation.

Example 5. N, a United States person, owns 50 percent of the outstanding shares of the only class of capital stock of foreign corporation R. An additional 48 percent of the outstanding shares is owned by foreign corporation S. The remaining 2 percent of shares is owned by P, a citizen and resident of foreign country T, who regularly acts as attorney for N in the conduct of N’s business affairs in country T. All of the shares of the outstanding capital stock of R Corporation are bearer shares. At the time of the issuance of the shares to him, P places the certificates for such shares in a depository to which N has access. On several occasions N, with P’s acquiescence, has taken such shares from the depository and, on one such occasion, used the shares as collateral in borrowing funds on a loan. Although dividends, when paid, are paid to P on his shares, his charges to N for legal fees are reduced by the amount of the dividends paid on such shares. Although P votes his shares at meetings of shareholders, the facts set forth above indicate an implied agreement between P and N that N is really to retain dominion over the stock. N is deemed to own the voting rights ostensibly attached to the stock owned by P, and R Corporation is a controlled foreign corporation.

Example 6. M, a domestic corporation which manufactures in the United States and distributes all of its production for foreign consumption through N, a person other than a related person or a United States person, forms foreign corporation S to purchase products from M Corporation and sell them to N. Corporations S and M have common directors. The outstanding capital stock of S Corporation consists of 10,000 shares of $100 par value class A stock, which has no voting rights except to vote for dissolution of the corporation on a share-for-share basis, and 500 shares of no par class B stock which has full voting rights. Each class of the outstanding stock is to participate on a share-for-share basis in any dividend. The class A
§ 1.957–2 Controlled foreign corporation deriving income from insurance of United States risks.

(a) In general. For purposes of taking into account only the income derived from the insurance of United States risks under §1.953–1, the term “controlled foreign corporation” means any foreign corporation of which more than