

stock has a preference as to assets on dissolution of the corporation to the extent of its par value as well as the right to participate with the class B stock in all other assets on a share for share basis. All of the shares of class A stock are issued to M Corporation in return for property having a value of \$1 million. Of the class B stock, 300 of the shares are issued to N in return for \$3,000 in cash and 200 shares are issued to M Corporation for \$2,000 in cash. At stockholder meetings N never votes in opposition to M Corporation on important issues. Corporation S has average annual earnings of \$200,000, all of which will be subpart F income if S Corporation is held to be a controlled foreign corporation. All such earnings are accumulated. Although N ostensibly has 60 percent of the voting power of S Corporation by virtue of his ownership of 300 shares of class B stock, he has the right to only approximately 3 percent of any dividends which may be paid by S Corporation; in addition, upon liquidation of S Corporation, N is entitled to share in the assets only after M Corporation has received the par value of its 10,000 shares of class A stock, or \$1 million. Thus, the voting power owned by N is substantially greater than its proportionate share of the earnings of S Corporation. In addition, the facts set forth above indicate that N is not exercising his voting rights independently and that a principal purpose of the capitalization arrangement is to avoid classification of S Corporation as a controlled foreign corporation. For these reasons, the voting power ostensibly provided the class B stock will be deemed owned by M Corporation, and S Corporation is a controlled foreign corporation.

Example 7. Foreign corporation A, authorized to issue 100 shares of one class of capital stock, issues, for \$1,000 per share, 45 shares to domestic corporation M, 45 shares to foreign corporation B, and 10 shares to foreign corporation C. Corporation C, a bank, lends \$3 million to finance the operations of A Corporation. In the course of negotiating these financial arrangements, D, an officer of C Corporation, and E, an officer of M Corporation, orally agree that C Corporation will vote its stock as M Corporation directs. By virtue of such oral agreement M Corporation possesses the voting power ostensibly owned by C Corporation, and A Corporation is a controlled foreign corporation.

Example 8. For its prior taxable year, JV, a foreign corporation, had outstanding 1000 shares of class A stock, which is voting common, and 1000 shares of class B stock, which is nonvoting preferred. DP, a domestic corporation, and FP, a foreign corporation, each owned precisely 500 shares of both class A and class B stock, and each elected 5 of the 10 members of JV's board of directors. The other facts and circumstances were such that JV was not a controlled foreign corpora-

tion on any day of the prior taxable year. On the first day of the current taxable year, DP purchased one share of class B stock from FP. JV was a controlled foreign corporation on the following day because over 50 percent of the total value in the corporation was held by a person that was a United States shareholder under section 951(b). See § 1.951-1(f).

Example 9. The facts are the same as in *Example 8* except that the stock of FP was publicly traded, FP had one class of stock, and on the first day of the current taxable year DP purchased one share of FP stock on the foreign stock exchange instead of purchasing one share of JV stock from FP. JV became a controlled foreign corporation on the following day because over 50 percent of the total value in the corporation was held by a person that was a United States shareholder under section 951(b).

Example 10. X, a foreign corporation, is incorporated under the laws of country Y. Under the laws of country Y, X is considered a mutual insurance company. X issues insurance policies that provide the policyholder with the right to vote for directors of the corporation, the right to a share of the assets upon liquidation in proportion to premiums paid, and the right to receive policyholder dividends in proportion to premiums paid. Only policyholders are provided with the right to vote for directors, share in assets upon liquidation, and receive distributions. United States policyholders contribute 25 percent of the premiums and have 25 percent of the outstanding rights to vote for the board of directors. Based on these facts, the United States policyholders are United States shareholders owning the requisite combined voting power and value. Thus, X is a controlled foreign corporation for purposes of taking into account related person insurance income under section 953(c).

(d) *Effective date.* Paragraphs (a) and (c) *Examples 8* through *10* of this section are effective for taxable years of a controlled foreign corporation beginning after November 6, 1995.

[T.D. 6688, 28 FR 11631, Oct. 31, 1963, as amended by T.D. 8216, 53 FR 27510, July 21, 1988; T.D. 8618, 60 FR 46529, Sept. 7, 1995; 60 FR 62026, Dec. 4, 1995; T.D. 8704, 62 FR 21, Jan. 2, 1997]

§ 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

25 percent, but not more than 50 percent, of the total combined voting power of all classes of stock entitled to vote is owned within the meaning of section 958(a), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day of the taxable year of such foreign corporation, but only if the gross amount of premiums received by such foreign corporation during such taxable year which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with United States risks, as defined in § 1.953-2 or 1.953-3, exceeds 75 percent of the gross amount of all premiums received by such foreign corporation during such year which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with all risks. The subpart F income for a taxable year of a foreign corporation which is a controlled foreign corporation for such taxable year within the meaning of this paragraph shall, subject to the provisions of section 952(b), (c), and (d), and § 1.952-1, include only the income derived from the insurance of United States risks, as determined under § 1.953-1.

(b) *Gross amount of premiums defined.* For a foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as—

(1) A life insurance company to which part I (sections 801 through 820) of subchapter L of the Code applies,

(2) A mutual insurance company to which part II (sections 821 through 826) of subchapter L of the Code applies, or

(3) A mutual marine insurance or other insurance company to which part III (sections 831 and 832) of subchapter L of the Code applies,

the term “gross amount of premiums” means, for purposes of paragraph (a) of this section, the gross amount of premiums and other consideration which are taken into account by a life insurance company under section 809(c)(1). Determinations for purposes of this paragraph shall be made without regard to section 501(a).

[T.D. 6795, 30 FR 942, Jan. 29, 1965]

§ 1.957-3 United States person defined.

(a) *Basic rule—(1) In general.* The term *United States person* has the same meaning for purposes of sections 951 through 965 that it has under section 7701(a)(30) and the regulations under that section, except as provided in paragraphs (b) and (c) of this section, which provide, with respect to corporations organized in possessions of the United States, that certain residents of such possessions are not United States persons. The effect of determining that an individual is not a United States person for such purposes is to exclude such individual in determining whether a foreign corporation created or organized in, or under the laws of, a possession of the United States is a controlled foreign corporation. See § 1.957-1 for the definition of the term “controlled foreign corporation.”

(2) *Special provisions applicable to possessions of the United States.* For purposes of this section—

(i) The term *possession of the United States* means Puerto Rico or any section 931 possession;

(ii) The term *section 931 possession* has the same meaning that it has under § 1.931-1(c)(1);

(iii) The rules of § 1.937-1 will apply for determining whether an individual is a bona fide resident of a possession of the United States;

(iv) Except as provided in paragraph (b)(2) of this section, the rules of § 1.937-2 will apply for determining whether income is from sources within a possession of the United States; and

(v) The rules of § 1.937-3 will apply for determining whether income is effectively connected with the conduct of a trade or business in a possession of the United States.

(b) *Puerto Rico corporation and resident.* An individual (who, without regard to this paragraph (b), is a United States person) will not be considered a United States person with respect to a foreign corporation created or organized in, or under the laws of, Puerto Rico for the taxable year of such corporation that ends with or within the taxable year of such individual if—

(1) Such individual is a bona fide resident of Puerto Rico during his entire taxable year in which or with which