

of this section does not necessarily mean that such activity constitutes a substantial transformation of property within the meaning of paragraph (a)(4) of § 1.954-3 for purposes of determining any foreign base company income of such corporation.

[T.D. 6683, 28 FR 11184, Oct. 18, 1963]

§ 1.957-4 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 964 which it has under section 7701(a)(30) and in the regulations thereunder, except as provided in section 957(d) and paragraphs (b), (c), and (d) 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, Puerto Rico, the Virgin Islands, or any possession of the United States (other than Puerto Rico or the Virgin Islands) is a controlled foreign corporation. See § 1.957-1 for definition of the term “controlled foreign corporation”; § 1.957-2 for a special limitation on the amount of subpart F income of certain controlled foreign corporations deriving income from the insurance of United States risks; and § 1.957-3 for the exclusion of certain corporations organized in United States possessions from the definition of controlled foreign corporation.

(2) *Special provisions applicable to possessions of the United States*. For purposes of section 957(d) and this section—

(i) *Possession of the United States defined*. The term “possession of the United States” has the same meaning which it has under paragraph (b)(2) of § 1.957-3.

(ii) *Determination of residence in a possession*. Whether an individual is a bona fide resident of Puerto Rico, the Virgin Islands, or any other possession of the United States, shall be determined in general by applying to the facts and circumstances in each case the principles of §§ 1.871-2 through 1.871-5, relat-

ing to the determination of residence in the United States.

(b) *Puerto Rico corporation and resident*. With respect only to a foreign corporation created or organized in, or under the laws of, Puerto Rico—

(1) If an individual (who, without regard to this paragraph, is a United States person) is a bona fide resident of Puerto Rico during his entire taxable year in which or with which the taxable year of such foreign corporation ends, and

(2) If 50 percent or more of the gross income of such foreign corporation is derived from sources within Puerto Rico, as determined under § 1.863-6, for the 3-year period (or for such part of such 3-year period as such foreign corporation has been in existence) ending with the close of the taxable year of such foreign corporation which—

(i) Ends with or within the taxable year next preceding such taxable year of such individual and at any time, during the period beginning with the beginning of such latter taxable year of such individual and ending not later than one year after the close of such taxable year of such foreign corporation, such individual directly owns stock in such foreign corporation, or

(ii) Ends within such taxable year of such individual and at any time, during the period beginning after the close of such taxable year of such foreign corporation and ending with the close of such taxable year of such individual, such individual directly owns stock in such foreign corporation,

then, such individual shall not be considered a United States person with respect to such corporation for the taxable year of such corporation which ends with or within the taxable year of such person. The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation R, incorporated under the laws of Puerto Rico, is wholly owned by D, a United States citizen. D and corporation R use the calendar year as the taxable year. For 1961, 1962, and 1963, 60 percent of the gross income of R Corporation is derived from sources within Puerto Rico and 40 percent of the gross income of R Corporation is derived from sources within Panama, as determined under § 1.863-6. During all of 1964, D is a bona fide resident of Puerto Rico. D is not a United States person with

respect to R Corporation for 1964. Accordingly, R Corporation is not a controlled foreign corporation at any time in 1964.

Example 2. Foreign corporation R is incorporated on January 1, 1962, under the laws of Puerto Rico. D, a United States citizen, owns all the one class of stock of R Corporation throughout 1962 and 1963. D and corporation R use the calendar year as the taxable year. For 1962, 55 percent of the gross income of R Corporation is derived from sources within Puerto Rico and 45 percent of the gross income of R Corporation is derived from sources within the Netherlands Antilles, as determined under § 1.863-6. For 1963, 40 percent of the gross income of R Corporation is derived from sources within Puerto Rico and 60 percent of the gross income of R Corporation is derived from sources within the Netherlands Antilles, as determined under § 1.863-6. During all of 1963 D is a bona fide resident of Puerto Rico. With respect to R Corporation, D is not a United States person for 1963 because D is a bona fide resident of Puerto Rico for all of 1963; 55 percent of the gross income of R Corporation for 1962 is derived from sources within Puerto Rico; and D owns stock in R Corporation at some time during 1963. Accordingly, R Corporation is not a controlled foreign corporation at any time in 1963. In making this determination, it is immaterial that R Corporation does not satisfy the 50-percent gross income test for 1963, the taxable year during all of which D is a resident of Puerto Rico.

Example 3. Foreign corporation R is incorporated on January 1, 1962, under the laws of Puerto Rico. D, a United States citizen, owns all the one class of stock of R Corporation throughout 1962 and 1963. D and corporation R use the calendar year as the taxable year. For 1962, 45 percent of the gross income of R Corporation is derived from sources within Puerto Rico and 55 percent of the gross income of R Corporation is derived from sources within the Netherlands Antilles, as determined under § 1.863-6. For 1963, 60 percent of the gross income of R Corporation is derived from sources within Puerto Rico and 40 percent of the gross income of R Corporation is derived from sources within the Netherlands Antilles, as determined under § 1.863-6. With respect to R Corporation, D is a United States person for 1963, since R Corporation does not satisfy the 50-percent gross income test for 1962. Accordingly, R Corporation is a controlled foreign corporation for all of 1963.

Example 4. Foreign corporation S is incorporated on July 1, 1962, under the laws of Puerto Rico. Corporation S uses the fiscal year ending on June 30 as the taxable year. For its fiscal year ending on June 30, 1963, 55 percent of the gross income of S Corporation is derived from sources within Puerto Rico and 45 percent of the gross income of S Corporation is derived from sources within Swit-

zerland, as determined under § 1.863-6. For its fiscal years ending on June 30, 1964, and June 30, 1965, respectively, 40 percent of the gross income of S Corporation is derived from sources within Puerto Rico and 60 percent of the gross income of S Corporation is derived from sources within Switzerland, as determined under § 1.863-6. B, a United States citizen, who uses the calendar year as the taxable year, is a bona fide resident of Puerto Rico for all of 1964. On July 1, 1964, B acquires, and holds throughout the remainder of 1964, all of the one class of stock of S Corporation. With respect to S Corporation for its taxable year ending June 30, 1964, B is a United States person because—

(a) Although B is a bona fide resident of Puerto Rico for his entire year 1964 in which ends S Corporation's taxable year ending June 30, 1964, and S Corporation meets the 50-percent gross income test for the applicable part of the 3-year period ending June 30, 1963, B does not own stock in S Corporation during the period beginning January 1, 1964, and ending June 30, 1964, and

(b) Although B owns stock in S Corporation during the period beginning July 1, 1964, and ending December 31, 1964, S Corporation does not meet the 50-percent gross income test for the applicable part of the 3-year period ending June 30, 1964.

Accordingly, with respect to B, S Corporation is a controlled foreign corporation for its entire taxable year ending June 30, 1964.

Example 5. The facts are the same as in example 4, except B buys all of the stock of S Corporation on June 1, 1964, rather than on July 1, 1964. With respect to S Corporation for its taxable year ending June 30, 1964, B is not a United States person because B is a bona fide resident of Puerto Rico for his entire taxable year 1964 in which ends S Corporation's taxable year ending June 30, 1964; S Corporation meets the 50-percent gross income test for the applicable part of the 3-year period ending June 30, 1963; and B owns stock in S Corporation during the period beginning January 1, 1964, and ending June 30, 1964. Accordingly, with respect to B, S Corporation is not a controlled foreign corporation at any time during its taxable year ending June 30, 1964.

(c) *Virgin Islands corporation and President.* With respect only to a foreign corporation created or organized in, or under the laws of, the Virgin Islands—

(1) If an individual (who, without regard to this paragraph, is a United States person) is a bona fide resident of the Virgin Islands as of the last day of his taxable year in which or with which the taxable year of such foreign corporation ends, and

(2) Such individual's income tax obligations under subtitle A (relating to income taxes) of the Code for his taxable year are satisfied, in accordance with section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642), by paying the tax on his income derived from all sources, both within and outside the Virgin Islands, into the treasury of the Virgin Islands, then, such individual shall not be considered a United States person with respect to such corporation for the taxable year of such corporation which ends with or within the taxable year of such person. The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation S, incorporated under the laws of the Virgin Islands, is wholly owned by D, a United States citizen. Corporation S uses the fiscal year ending on June 30 as the taxable year, and D uses the calendar year as the taxable year. From September 1, 1963, to December 31, 1964, inclusive, D is a bona fide resident of the Virgin Islands. For 1963 and 1964, D satisfies his income tax obligations under section 28(a) of the Revised Organic Act of the Virgin Islands by paying the tax on his income derived from all sources, both within and outside the Virgin Islands, into the treasury of the Virgin Islands. With respect to S Corporation for its taxable years ending June 30, 1963, and 1964, D is not a United States person. Accordingly, S Corporation is not a controlled foreign corporation for such taxable years of such corporation.

Example 2. The facts are the same as in example 1, except that from August 15, 1964, to December 31, 1964, inclusive, D is a bona fide resident of the United States. Thus, D does not satisfy his income tax obligations for 1964 under section 28(a) of the Revised Organic Act of the Virgin Islands. The result is the same as in example 1, except that with respect to S Corporation for its taxable year ending June 30, 1964, D is a United States person and, accordingly, S Corporation is a controlled foreign corporation for such taxable year of such corporation.

(d) *Corporation and resident of other United States possessions.* With respect only to a foreign corporation created or organized in, or under the laws of, any possession of the United States (other than Puerto Rico or the Virgin Islands)—

(1) If an individual (who, without regard to this paragraph, is a United States person) is a bona fide resident of such possession during his entire tax-

able year in which or with which the taxable year of such foreign corporation ends, and

(2) Any part or all of such individual's income (other than amounts includible in his gross income under section 951(a)) for his taxable year derived, in accordance with §1.863-6, from sources within any possession of the United States (whether or not the possession of which such individual is a resident) is not, as a result of the application of section 931, included in his gross income for his taxable year,

then, such individual shall not be considered a United States person with respect to such corporation for the taxable year of such corporation which ends with or within the taxable year of such person. Subparagraph (2) of this paragraph shall apply only for purposes of determining whether an individual is a United States person; after such determination has been made, section 931 shall be applied to the gross income (including amounts includible in gross income under section 951(a)) of such individual to determine the amount to be excluded from such individual's gross income under section 931. The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation R, incorporated under the laws of Guam, is wholly owned by D, a United States citizen. D and corporation R use the calendar year as the taxable year and the cash receipts and disbursements method of accounting. D is a bona fide resident of Guam for all of 1963 and all of his income of \$30,000 (determined without taking into account amounts includible in his gross income under section 951(a)) is derived from sources within Guam. Of such income, \$24,000 is received in Guam and \$6,000 is received in the United States. It meets the 3-year test of section 931(a) and, but for the application of section 931(b), all of his income of \$30,000 would be excluded from gross income for 1963 under section 931. However, in accordance with section 931(b) and paragraph (c) of §1.931-1, the \$6,000 received in the United States is included in gross income. Nevertheless, since part (\$24,000) of his income of \$30,000 for 1963 derived, in accordance with §1.863-6, from sources within Guam is not, as a result of the application of section 931, included in his gross income, D is not a United States person with respect to R Corporation for its taxable year 1963. Accordingly, R Corporation is not a controlled foreign corporation for its taxable year 1963.

Example 2. The facts are the same as in example 1, except that, instead of receiving the \$6,000 in the United States, D receives \$10,000 of the \$30,000 in Guam for services performed for an agency of the United States. Under § 1.863-6, all of D's income for 1963 is income derived from sources within Guam. However, since D's income of \$10,000 from the agency of the United States is deemed under section 931 (i) to be derived from sources within the United States for purposes of section 931, at least 80 percent of his gross income for 1963, determined without the application of section 931, is not derived from sources within Guam. Accordingly, since no part of D's gross income of \$30,000 for 1963 derived, in accordance with § 1.863-6, from sources within Guam is, as a result of the application of section 931, excluded from gross income for 1963, D is a United States person with respect to R Corporation for R Corporation's taxable year 1963. Accordingly, R Corporation is a controlled foreign corporation for its taxable year 1963.

[T.D. 6775, 29 FR 16082, Dec. 2, 1964]

§ 1.958-1 Direct and indirect ownership of stock.

(a) *In general.* Section 958(a) provides that, for purposes of sections 951 to 964 (other than sections 955(b)(1)(A) and (B) and 955(c)(2)(A)(ii) (as in effect before the enactment of the Tax Reduction Act of 1975), and 960(a)(1)), stock owned means—

- (1) Stock owned directly; and
- (2) Stock owned with the application of paragraph (b) of this section.

The rules of section 958(a) and this section provide a limited form of stock attribution primarily for use in determining the amount taxable to a United States shareholder under section 951(a). These rules also apply for purposes of other provisions of the Code and regulations which make express reference to section 958(a).

(b) *Stock ownership through foreign entities.* For purposes of paragraph (a)(2) of this section, stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, foreign trust (within the meaning of section 7701(a)(31)) described in sections 671 through 679, or other foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, grantors or other persons treated as owners under sections 671 through 679 of any portion

of the trust that includes the stock, or beneficiaries, respectively. Stock considered to be owned by reason of the application of this paragraph shall, for purposes of reapplying this paragraph, be treated as actually owned by such person. Thus, this rule creates a chain of ownership; however, since the rule applies only to stock owned by a foreign entity, attribution under the rule stops with the first United States person in the chain of ownership running from the foreign entity. The application of this paragraph may be illustrated by the following example:

Example. Domestic corporation M owns 75 percent of the one class of stock in foreign corporation R, which in turn owns 80 percent of the one class of stock in foreign corporation S, which in turn owns 90 percent of the one class of stock in foreign corporation T. Under this paragraph, R Corporation is considered as owning 80 percent of the 90 percent of the stock which S Corporation owns in T Corporation, or 72 percent. Corporation M is considered as owning 75 percent of such 72 percent of the stock in T Corporation, or 54 percent. Since M Corporation is a domestic corporation, the attribution under this paragraph stops with M Corporation, even though, illustratively, such corporation is wholly owned by domestic corporation N.

(c) *Rules of application—(1) Special rule for mutual insurance companies.* For purposes of applying paragraph (a) of this section in the case of a foreign mutual insurance company, the term "stock" shall include any certificate entitling the holder to voting power in the corporation.

(2) *Amount of interest in foreign corporation, foreign partnership, foreign trust, or foreign estate.* The determination of a person's proportionate interest in a foreign corporation, foreign partnership, foreign trust, or foreign estate will be made on the basis of all the facts and circumstances in each case. Generally, in determining a person's proportionate interest in a foreign corporation, the purpose for which the rules of section 958(a) and this section are being applied will be taken into account. Thus, if the rules of section 958(a) are being applied to determine the amount of stock owned for purposes of section 951(a), a person's proportionate interest in a foreign corporation will generally be determined with reference to such person's interest