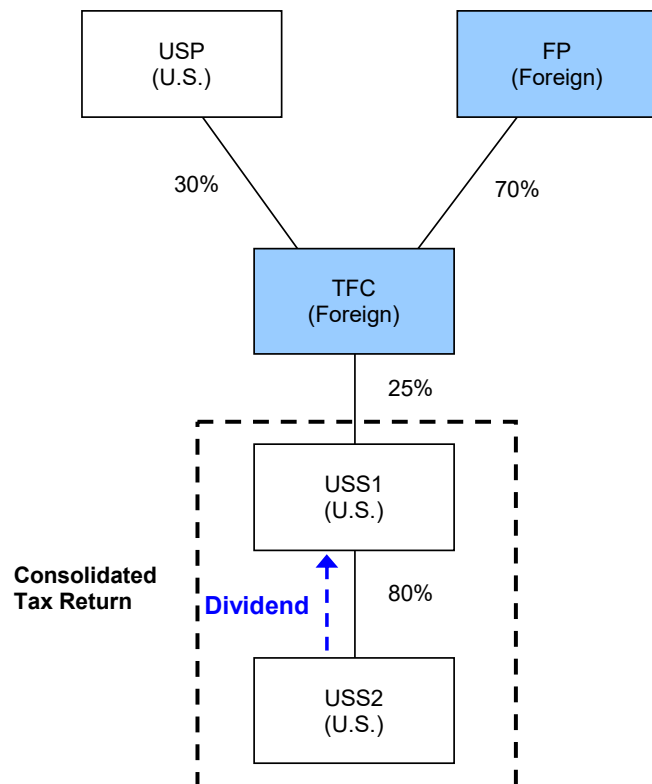


**Prop. Reg. 1.1297-1(b)(2),
Example**

**Consolidated Group Dividends Not Excluded
From Gross Income for PFIC Testing**

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USP is a domestic corporation that owns 30% of TFC, a foreign corporation. The remaining 70% of TFC is owned by FP, a foreign corporation that is unrelated to USP. TFC owns 25% of the value of USS1, a domestic corporation. USS1 owns 80% of the value of USS2, a domestic corporation. USS1 and USS2 are members of an affiliated group (as defined in section 1504(a)) filing a consolidated return. USS2 distributes a dividend to USS1 that is excluded from USS1's income pursuant to Reg. 1.1502-13 for purposes of determining the U.S. Federal income tax liability of the affiliated group of which USS1 and USS2 are members.

Although the dividend received by USS1 from USS2 is excluded from USS1's income for purposes of determining the U.S. Federal income tax liability of the affiliated group of which USS1 and USS2 are members, pursuant to Reg. 1.1297-1(b)(1), for purposes of section 1297, USS1's gross income includes the USS2 dividend. Accordingly, for purposes of section 1297, TFC's gross income includes 25% of the dividend received by USS1 from USS2 pursuant to section 1297(c) and Reg. 1.1297-2(b)(2)(ii). See section 1298(b)(7) and Reg. 1.1298-4 for rules concerning the characterization of the USS2 dividend.