Reg. 1.951-1(e)(6), Example 6

Pro Rata Share - Restriction on Common Dividends is Disregarded

FC6, a CFC, has outstanding 10 shares of common stock and 400 shares of 2-percent nonparticipating, voting, preferred stock with a par value of $1x per share. The common shareholders are entitled to dividends when declared by the board of directors of FC6. Corp M, a domestic corporation and a United States shareholder of FC6, owns all of the common shares. FC7, a foreign corporation that is not a CFC, owns all of the preferred shares. Corp M and FC7 cause the governing documents of FC6 to provide that no dividends may be paid to the common shareholders until FC6 cumulatively earns $100,000x of income. Corp M and FC7 are shareholders of FC6 for all of 2005. For 2005, FC6 has $50x of earnings and profits, and income of $50x. In 2005, FC6 distributes as a dividend $8x to FC7 with respect to FC7’s preferred shares. FC6 makes no other distributions during that year.

The agreement restricting FC6’s ability to pay dividends to common shareholders until FC6 cumulatively earns $100,000x of income will be disregarded for purposes of calculating Corp M's pro rata share of subpart F income. If the total $50x of earnings were distributed on December 31, 2005, $8x would be distributed with respect to FC7’s preferred shares and the remainder, $42x, would be distributed with respect to Corp M's common shares. Accordingly, Corp M's pro rata share of FC6's subpart F income is $42x for taxable year 2005.

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