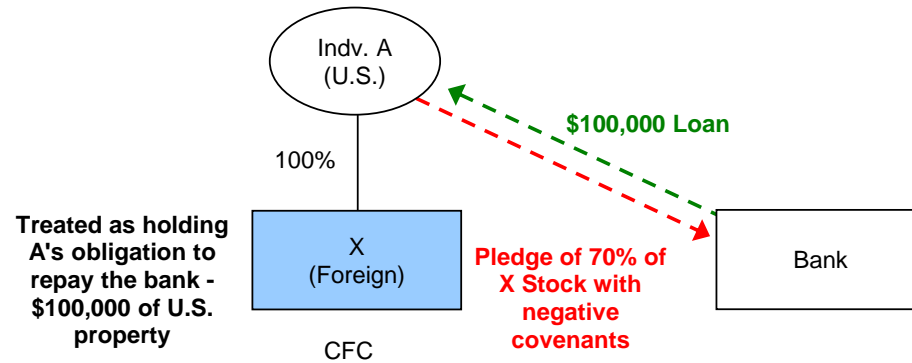


**U.S. Property - Pledge of >2/3 of CFC Stock with Negative Covenants**



A, a United States person, borrows \$100,000 from a bank on December 10, 1981, pledging 70 percent of the stock of X, a controlled foreign corporation, as collateral for the loan. A and X use the calendar year as their taxable year. In the loan agreement, among other things, A agrees not to cause or permit X Corporation to do any of the following without the consent of the bank:

- (a) Borrow money or pledge assets, except as to borrowings in the ordinary course of business of X Corporation;
- (b) Guarantee, assume, or become liable on the obligation of another, or invest in or lend funds to another;
- (c) Merge or consolidate with any other corporation or transfer shares of any controlled subsidiary;
- (d) Sell or lease (other than in the ordinary course of business) or otherwise dispose of any substantial part of its assets;
- (e) Pay or secure any debt owing by X Corporation to A; and
- (f) Pay any dividends, except in such amounts as may be required to make interest or principal payments on A's loan from the bank.

A retains the right to vote the stock unless a default occurs by A. Under Treas. Reg. §1.956-1(c)(2), the assets of X Corporation serve indirectly as security for A's performance of A's obligation to repay the loan and X Corporation will be considered a pledgor or guarantor with respect to that obligation. For purposes of Treas. Reg. §1.956-1(b), X Corporation will be considered to hold A's obligation to repay the bank \$100,000 and under Treas. Reg. §1.956-1(e)(2), the amount taken into account in computing X Corporation's aggregate investment in United States property on December 31, 1981, is the unpaid principal amount of the obligation on that date.