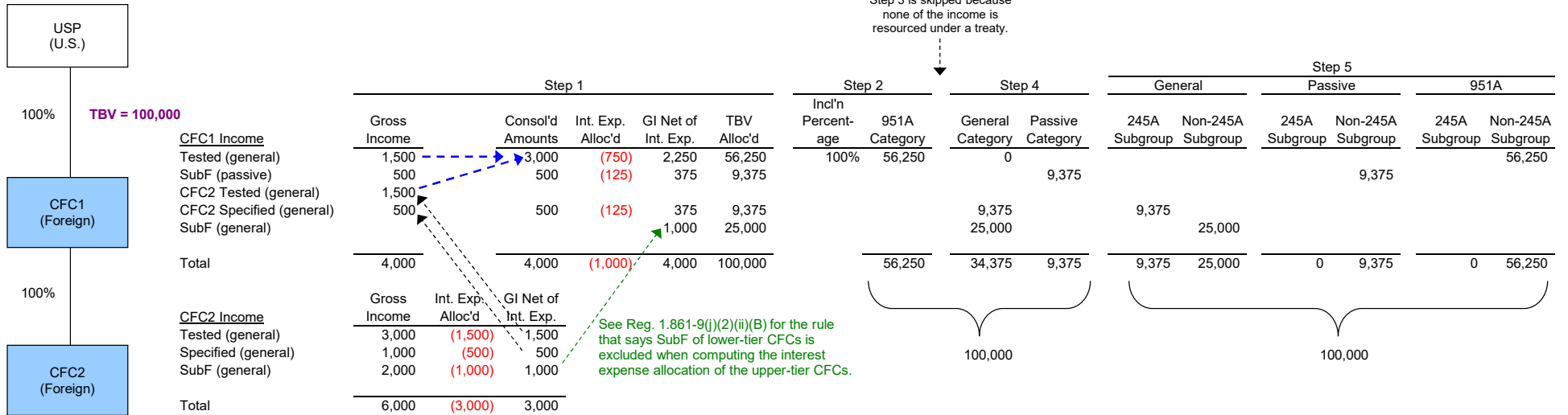


Reg. 1.861-13(c)(3), Example 3

Characterization of CFC Stock: Modified Gross Income Method With Two CFCs



- Facts -
- (A) USP, a domestic corporation, directly owns all of the stock of a controlled foreign corporation, CFC1. The tax book value of CFC1's stock is \$100,000x. CFC1 owns all of the stock of CFC2, a controlled foreign corporation. USP uses the modified gross income method described in Reg. 1.861-12(c)(3)(iii) to characterize the stock in CFC1. USP's inclusion percentage is 100%.
 - (B) CFC1 earns \$1,500x of foreign source gross tested income within the general category and \$500x of foreign source gross subpart F income within the passive category. CFC1 incurs \$1,000x of interest expense.
 - (C) CFC2 earns \$3,000x of foreign source gross tested income within the general category, \$2,000x of foreign source gross subpart F income within the general category, and \$1,000x of specified foreign source general category gross income. CFC2 incurs \$3,000x of interest expense.