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overpayment of tax may be filed, however, if the taxpayer subsequently qualifies for any exclusion or deduction under section 911. See section 6012(c) and §1.6012–1(a)(3), relating to returns to be filed and information to be furnished by individuals who qualify for any exclusion or deduction under section 911.

(d) *Declaration of estimated tax.* In estimating gross income for the purpose of determining whether a declaration of estimated tax must be made for any taxable year, an individual is not required to take into account income which the individual reasonably believes will be excluded from gross income under the provisions of section 911. In computing estimated tax, however, the individual must take into account, among other things, the denial of the foreign tax credit for foreign taxes allocable to the excluded income (see §1.911–6(c)).

(e) *Effective/applicability date.* This section applies to applications for extension of time to file returns filed after July 1, 2008.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2976, Jan. 23, 1985, as amended by T.D. 8480, 58 FR 34885, June 30, 1993; 73 FR 37365, July 1, 2008]

§1.911–8 Former deduction for certain expenses of living abroad.

For rules relating to the deduction for certain expenses of living abroad applicable to taxable years beginning before January 1, 1982, see 26 CFR 1.913–1 through 1.913–13 as they appeared in the Code of Federal Regulations revised as of April 1, 1982.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2977, Jan. 23, 1985]

EARNED INCOME OF CITIZENS OF UNITED STATES

§1.912–1 Exclusion of certain cost-of-living allowances.

(a) Amounts received by Government civilian personnel stationed outside the continental United States as cost-of-living allowances in accordance with regulations approved by the President are, by the provisions of section 912(1), excluded from gross income. Such allowances shall be considered as retaining their characteristics under section 912(1) notwithstanding any combination thereof with any other allowance. For example, the cost-of-living portion of a ''living and quarters allowance'' would be excluded from gross income whether or not any other portion of such allowance is excluded from gross income.

(b) For purposes of section 912(1), the term ''continental United States'' includes only the 48 States existing on February 25, 1944 (the date of the enactment of the Revenue Act of 1943 (58 Stat. 21)) and the District of Columbia.

§1.912–2 Exclusion of certain allowances of Foreign Service personnel.

Gross income does not include amounts received by personnel of the Foreign Service of the United States as allowances or otherwise under the provisions of chapter 9 of title I of the Foreign Service Act of 1980 or the provisions of section 28 of the State Department Basic Authorities Act (formerly section 914 of title IX of the Foreign Service Act of 1946).

[T.D. 8256, 54 FR 28620, July 6, 1989]

§1.921–1T Temporary regulations providing transition rules for DISCs and FSCs.

(a) *Termination of a DISC*—(1) *At end of 1984.*

Q–1: What is the effect of the termination on December 31, 1984, of a DISC's taxable year?

A–1: Without regard to the annual accounting period of the DISC, the last taxable year of each DISC beginning during 1984 shall be deemed to close on December 31, 1984. The corporation's DISC election also shall be deemed revoked at the close of business on December 31, 1984. (A DISC that does not elect to be an interest charge DISC as of January 1, 1985, in addition to a corporation described in section 992(a)(3), shall be referred to as a ''former DISC''.) A corporation which wishes to be treated as a FSC, a small FSC, or an interest charge DISC must make an election as provided under paragraph (b) (Q & A #1) of this section.

(2) *Deemed distributions for short taxable years.*

Q–2: If the termination of the DISC's taxable year on December 31, 1984, results in a short taxable year, how are the deemed distributions under section 995(b)(1)(E) determined?

A–2: The deemed distributions are determined on the basis of the DISC's taxable income for its short taxable year ending on December 31, 1984. In computing the incremental distribution under section 995(b)(1)(E), the export gross receipts for the short taxable year must be annualized.

(3) *Qualification as a DISC for 1984.*

Q–3: Must the DISC satisfy all the tests set forth in section 992(a)(1) for the DISC's taxable year ending December 31, 1984?

A–3: All of the tests under section 992(a)(1), except the qualified assets test under section 992(a)(1)(B), must be satisfied.

(4) *Commissions for 1984.*

Q–4: Must commissions be paid by a related supplier to a DISC with respect to the DISC's taxable year ending December 31, 1984?

A–4: No.

Q–4A: Must commissions which were earned prior to January 1, 1985, be paid by a related supplier if the last date payment is required (as set forth in §1.994–1(e)(3)) is after December 31, 1984?

A–4A: No.

(5) *Producer's loans of 1984.*

Q–5: Must the producer's loan rules under section 993(d) be satisfied with respect to the DISC's taxable year ending December 31, 1984?

A–5: Yes.

(6) *Accumulated DISC income.*

Q–6. Under what circumstances is any remaining accumulated DISC income treated as previously taxed income (and not taxed)?

A–6. The accumulated DISC income of a DISC (but not a DISC described in section 992(a)(3)) as of December 31, 1984, is treated as previously taxed income when actually distributed after December 31, 1984. Any amounts distributed by the former DISC (including a DISC which has elected to be an interest charge DISC) after December 31, 1984, shall be treated as made first out of current earnings and profits and then out of previously taxed income to the extent thereof. For purposes of the preceding sentence, amounts distributed before July 1, 1985, shall be treated as made first out of previously taxed income to the extent thereof. If property other than money is distributed and if such property was a qualified export asset within the meaning of section 993(b) on December 31, 1984, then for purposes of section 311, no gain or loss will be recognized on the distribution and the distributee will have the same basis in the property as the distributor.

Q–7: May a DISC that was previously disqualified, but has requalified as of December 31, 1984, treat any accumulated DISC income as previously taxed income?

A–7: If a DISC was previously disqualified, but has requalified as of December 31, 1984, any accumulated DISC income previously required to be taken into income upon prior disqualification shall not be treated as previously taxed income. All accumulated DISC income derived since requalification, however, will be treated as previously taxed income.

(7) *Distribution of previously taxed income.*

Q–8: What effect will the distribution of previously taxed income have on the earnings and profits of corporate shareholders of the former DISC?

A–8: The earnings and profits of the corporate shareholders of the former DISC will be increased by the amount of money and the adjusted basis of any property which is distributed out of previously taxed income.

Q–9: Will the distribution of the former DISC's accumulated DISC income as previously taxed income after December 31, 1984, result in a reduction in the shareholder's basis of the stock of the former DISC and consequent taxation of the excess of the distribution over such basis as capital gain under section 996(d)?

A–9: No. This distribution will be treated both as amounts representing deemed distributions under section 995(b)(1) and as previously taxed income. Thus, no capital gain will arise.

(8) *Qualifying distributions.*

Q–10: How is a qualifying distribution to satisfy the qualified export receipts

tests under section 992(c)(1)(A) which is made with respect to the DISC's taxable year ending on December 31, 1984, treated?

A–10: The distribution will not be treated as previously taxed income but will be taxed to the shareholder of the former DISC, as provided under section 992(c) and 996(a)(2) and the regulations thereunder, in the shareholder's taxable year in which the distribution is made.

(9) *Deficiency distributions.*

Q–11: With respect to an audit adjustment made after December 31, 1984, may a deficiency distribution be made, and if so, in what manner may it be made?

A–11: A deficiency distribution may be made notwithstanding the fact that after December 31, 1984, the former DISC is a taxable corporation under subchapter C, has elected to be treated as an interest charge DISC, or has been liquidated, reorganized or is otherwise no longer in existence. However, such deficiency distribution shall be treated as made out of accumulated DISC income which is not previously taxed income because it will be treated as distributed prior to December 31, 1984, to the DISC's shareholders.

Q–11A: Must a former DISC remain in existence in order for a former DISC shareholder to take advantage of the spread provided in section 995(b)(2) with respect to DISC disqualification?

A–11A: No. With respect to distributions deemed to be received by a former DISC shareholder under section 995(b)(2) for taxable years beginning after December 31, 1984, if the former DISC shareholder elects, the rules of section 995(b)(2)(B) shall apply even though the former DISC does not continue in existence. If the former DISC is no longer in existence, the former DISC's shareholders will be deemed to have received the distribution on the last day of their taxable years over the applicable period of time determined under section 995(b)(2) as if the former DISC had remained in existence.

(10) *Deemed distribution for 1984.*

Q–12: How is the deemed distribution to a shareholder for the DISC's taxable year ending December 31, 1984, taken into account?

A–12 (i) If the taxable year of the DISC ending on December 31, 1984, (A) is the first taxable year of the DISC which begins in 1984, (B) begins after the date in 1984 on which the taxable year of the DISC's shareholder begins, and (C) if the DISC's shareholder makes an election under section 805(b)(3) of the Tax Reform Act of 1984, the deemed distribution under section 995(b) with respect to income derived by the DISC for such taxable year of the DISC shall be treated as received by the shareholder in 10 equal installments (unless the shareholder elects to be treated as receiving the deemed distribution in income over a smaller number of equal installments). The first installment shall be treated as received by the shareholder on the last day of the shareholder's second taxable year beginning in 1984 (if any), or if the shareholder had only one taxable year which began in 1984, on the last day of the shareholder's first taxable year beginning in 1985. One installment shall be treated as received by the shareholder on the last day of each succeeding taxable year of the shareholder until the entire amount of the DISC's 1984 deemed distribution has been included in the shareholder's taxable income. To make the election under section 805(b)(3) of the Tax Reform Act of 1984, the DISC shareholder must attach a statement to its timely filed tax return (including extensions) for its taxable year which includes December 31, 1984, indicating the total amount of the shareholder's pro rata share of the DISC's deemed distribution for 1984 (determined under section 995(b) of the Code without regard to the election under section 805(b)(3) of the Tax Reform Act of 1984), and the number of equal installments, if less than 10, over which the shareholder wishes to spread its pro rata share of the deemed distribution for 1984. If the election under section 805(b)(3) of the Tax Reform Act of 1984 is made, it may not be changed or revoked. In determining estimated tax payments, the portion of the deemed distribution includible in the shareholder's taxable income for any taxable year under this subdivision (i) shall be treated as received by the shareholder on the last day of such taxable year.

(ii) Except as provided in subdivision (i), the deemed distribution under section 995(b) with respect to income derived by the DISC for its taxable year ending on December 31, 1984, shall be included in the shareholder's taxable income for its taxable year which includes December 31, 1984. Thus, if the taxable year of the DISC and the DISC's shareholder both begin on January 1, 1984, and end on December 31, 1984 (or, if the taxable year of the DISC beginning in 1984 begins before the taxable year of the DISC's shareholder), the deemed distribution with respect to the DISC's taxable year ending on December 31, 1984, will be included in the DISC shareholder's taxable year ending on (or including) December 31, 1984, and the election described in subdivision (i) may not be made.

(iii) The provisions of this Question and Answer-12 apply without regard to any existence of the DISC after December 31, 1984, as an interest charge DISC.

Q–12A: If under section 805(b)(3) of the Tax Reform Act of 1984 the shareholders of the DISC are permitted to make an election to treat the DISC's 1984 deemed distribution as received over a 10-year period, must the DISC distribute that amount to its shareholders ratably over the 10-year period?

A–12A: No. Under section 805(b)(3) of the Tax Reform Act of 1984, if the DISC's deemed distribution for its taxable year which ended on December 31, 1984, is a qualified distribution, the shareholders of the DISC are permitted to make an election to treat the distribution as received over a 10-year period. The 10-year treatment applies even though the amount of the deemed distribution is distributed to the DISC's shareholders prior to the period in which the distribution is taken into income by the shareholders. In addition, under section 996(e) of the Code, the shareholder's basis in the stock of the DISC will be considered as increased, as of the date of liquidation, by the shareholder's pro rata share of the amount of the undistributed qualified distribution even though that amount is treated as received by the shareholder in later years. Further, the actual distribution in liquidation of the former DISC after 1984 will increase the earnings and profits of a corporate distributee, and the amount actually distributed shall be treated under the rules of section 996.

(11) *Conformity of accounting period.*

Q–13: May a DISC be established or change its annual accounting period for taxable years beginning after March 21, 1984, and before January 1, 1985?

A–13: A DISC that is established or that changes its annual accounting period after March 21, 1984, must conform its annual accounting period to that of its principal shareholder (the shareholder with the highest percentage of voting power as defined in section 441(h)).

(12) *DISC gains and distributions from U.S. sources.*

Q–14: What is the effective date of the amendment to section 996(g), made by section 801(d)(10) of the Tax Reform Act of 1984, which treats certain DISC gains and distributions as derived from sources within the United States?

A–14: Under section 805(a)(3) of the Act, the amendment to section 996(g) shall apply to all gains referred to in section 995(c) and all distributions out of accumulated DISC income including deemed distributions made on or after June 22, 1984.

(b) *Establishing and electing status as a FSC, small FSC or interest charge DISC—* (1) *Ninety-day period.*

Q–1: How does a corporation elect to be treated as a FSC, a small FSC, or an interest charge DISC?

A–1: A corporation electing FSC or small FSC status must file Form 8279. A corporation electing interest charge DISC status must file Form 4876A. A corporation electing to be treated as a FSC, small FSC, or interest charge DISC for its first taxable year shall make its election within 90 days after the beginning of that year. A corporation electing to be treated as a FSC, small FSC, or interest charge DISC for any taxable year other than its first taxable year shall make its election during the 90-day period immediately preceding the first day of that taxable year. The election to be a FSC, small FSC, or interest charge DISC may be made by the corporation, however, during the first 90 days of a taxable year, even if that taxable year is not the corporation's first taxable year, if that

taxable year begins before July 1, 1985. Likewise, the election to be a FSC (or a small FSC) may be made during the first 90 days of any taxable year of a corporation if the corporation had in a prior taxable year elected small FSC (or FSC) status and the corporation revokes the small FSC (or FSC) election within the 90 day period. A corporation which was a DISC for its taxable year ending December 31, 1984, which wishes to be treated as an interest charge DISC beginning with its first taxable year beginning after December 31, 1984, may make the election to be treated as an interest charge DISC by filing Form 4876A on or before July 1, 1987. Also, if a corporation which has elected FSC, small FSC or interest charge DISC status, or a shareholder of that corporation, is acquired in a qualified stock purchase under section 338(d)(3), and if an election under section 338(a) is effective with regard to that corporation, the corporation may re-elect FSC, small FSC or interest charge DISC status, (whichever is applicable) not later than the date of the election under section 338(a), see section 338(g)(i) and §1.338–2(d). This re-election is necessary because the original elections are deemed terminated if an election is made under section 338(a). The rules contained in §1.992–2 (a)(1), (b)(1) and (b)(3) shall apply to the manner of making the election and the manner and form of shareholder consent.

(2) *FSC incorporated in a possession.*

Q–2: Where does a FSC which is incorporated in a U.S. possession file its election?

A–2: The election is filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255.

(3) *Information returns.*

Q–3: Must Form 5471 be filed with respect to the organization of a FSC pursuant to section 6046 or to provide information with respect to a FSC pursuant to section 6038?

A–3: A Form 5471 required under section 6046 need not be filed with respect to the organization of a FSC. The requirements of section 6046 shall be satisfied by the filing of a Form 8279 dealing with the election to be treated as a FSC or small FSC. However, a Form 5471 will be required with respect to a reorganization of a FSC (or small FSC) or an acquisition of stock of a FSC (or small FSC), as required under section 6046 and the regulations thereunder. Provided that a Form 1120 FSC is filed, a Form 5471 need not be filed to satisfy the requirements of section 6038.

(4) *Conformity of accounting period.*

Q–4: Since a FSC, small FSC, and interest charge DISC must use the same annual accounting period as the principal shareholder, must such corporation delay the beginning of its first taxable year beyond January 1, 1985 if the principal shareholder (the shareholder with the highest percentage of voting power as defined in section 441(h)) is not a calendar year taxpayer?

A–4: No. Where the principal shareholder is not a calendar year taxpayer, a corporation may elect to be treated as a FFSC, small FSC, or interest charge DISC for a taxable year beginning January 1, 1985. However, such corporation must close its first taxable year and adopt the annual accounting period of its principal shareholder as of the first day of the principal shareholder's first taxable year beginning in 1985. A FSC, small FSC, or interest charge DISC need not obtain the consent of the Commissioner under section 442 to conform its annual accounting period to the annual accounting period of its principal shareholder.

(5) *Dollar limitations for short taxable years.*

Q–5: If a small FSC or an interest charge DISC has a short taxable year, how are the dollar limitations on foreign trading export gross receipts and qualified export gross receipts, respectively, determined for small FSCs and interest charge DISCs?

A–5: The dollar limitations are to be prorated on a daily basis. Thus, for example, if for its 1985 taxable year a small FSC has a short taxable year of 73 days, then in determining exempt foreign trade income, any foreign trading gross receipts that exceed $1 million (73/365 × $5 million) will not be taken into account.

(6) *Change of accounting period.*

Q–6: If the principal shareholder of a FSC, a small FSC, or an interest charge DISC (hereinafter referred to as a ''FSC'') changes its annual accounting period or is replaced by a new principal shareholder during a taxable

year, is it necessary for the FSC to change its annual accounting period?

A–6: If the principal shareholder changes its annual accounting period, the FSC must also change its annual accounting period to conform to that of its principal shareholder. If the voting power of the principal shareholder is reduced by an amount equal to at least 10 percent of the total shares entitled to vote and such shareholder is no longer the principal shareholder, the FSC must conform its accounting period to that of its new principal shareholder. However, in determining whether a shareholder is a principal shareholder, the voting power of the shareholders is determined as of the beginning of the FSC's taxable year. Thus, for example, assume that for 1985 a FSC adopts a calendar year period as its annual accounting period to conform to that of its principal shareholder. Assume further than in March 1985 there is a 10 percent change in voting power and a different shareholder whose annual accounting period begins on July 1 becomes the new principal shareholder. The FSC will not be required to adopt the annual accounting period of its new principal shareholder until July 1, 1986. The FSC will have a short taxable year for the period January 1 to June 30, 1986.

(7) *Transition transfers.*

Q–7. Under what circumstances may a DISC or former DISC transfer its assets to a FSC or small FSC without incurring any tax liability on the transfer?

A–7. A DISC or former DISC will recognize no income, gain, or loss on a transfer of its qualified assets (as defined in section 993(b)) to a FSC or small FSC if all of the following conditions are met:

(i) The assets transferred were held by the DISC on August 4, 1983, and were transferred by the DISC or former DISC to the FSC or small FSC in a transfer completed before January 1, 1986; and

(ii) The assets are transferred in a transaction which would qualify for nonrecognition under subchapter C of chapter 1 of the Code, or would so qualify but for section 367 of the Code.

In such case, section 367 shall not apply to the transfer.

In addition, other provisions of subchapter C will apply to the transfer, such as section 358 (basis to shareholders), section 362 (basis to corporations), and section 381 (carryovers in corporate acquisitions). In determining whether a transfer by a DISC to a FSC or small FSC qualifies for nonrecognition under subchapter C, a liquidation of the assets of the DISC into a parent corporation followed by a transfer by the parent of those assets to the FSC or small FSC will be treated as a transaction described in section 368(a)(1)(D).

Notwithstanding the foregoing answer, a taxpayer which transfers a right to use its corporate name to a FSC in a transaction described in sections 332, 351, 354, 356 and 361 shall not be treated as having sold that right under section 367(d) or as having transferred that right to an entity that is not a corporation under section 367(a) provided that the corporate name is used only by the FSC and is not licensed or otherwise made available to others by the FSC.

(8) *Completed contract method.*

Q–8: Under what conditions is a taxpayer using the completed contract method of accounting as defined in §1.451–3(d) exempted from satisfying the foreign management and foreign economic process requirements of subsections (c) and (d) of section 924?

A–8: If the taxpayer has entered into a binding contract before March 16, 1984, or has on March 15, 1984, and at all times thereafter a firm plan, evidenced in writing, to enter the contract and enters into a binding contract by December 31, 1984, then the taxpayer will be treated as having satisfied the foreign management tests of section 924(c) for periods before December 31, 1984, and the foreign economic process tests of section 924(d) with respect to costs incurred before December 31, 1984, with respect to the transaction. The FSC rules will apply to the income from the long-term contract if an election is made and the general FSC requirements under section 922 are satisfied. However, such taxpayer need not satisfy the activities test under section 925(c) for activities which occur before January 1, 1985 in order to use the transfer pricing rules under section 925.

(9) *Long-term contract—before March 15, 1984.*

Q–9: Under what conditions is a taxpayer who enters into a binding long-term contract (*i.e.*, a contract which is not completed in the taxable year in which it is entered into) before March 15, 1984, but does not use the completed contract method of accounting exempted from satisfying the foreign management and economic process requirements of subsections (c) and (d) of section 924?

A–9: If a taxpayer enters into a binding contract before March 15, 1984, the taxpayer will be treated as having satisfied the foreign management tests of section 924(c) for periods before December 31, 1984, and the foreign economic process tests of section 924(d) with respect to costs incurred before December 31, 1984, but only with respect to income attributable to such contracts that is recognized before December 31, 1986. The FSC rules will apply to the income from the long-term contract if an election is made and the general FSC requirements under section 922 are satisfied. However, such taxpayer need not satisfy the activities test under section 925(c) for activities which occur before January 1, 1985, in order to use the transfer pricing rules under section 925.

(10) *Long-term contract—after March 15, 1984.*

Q–10: Under what conditions is a taxpayer who has a long-term contract (i.e., a contract which is not completed in the taxable year in which it is entered into) but does not use the completed contract method of accounting exempted from satisfying the foreign management and economic process requirements of subsections (c) and (d) of section 924 if such taxpayer enters into a binding contract after March 15, 1984 and before January 1, 1985?

A–10: If a taxpayer enters into a contract after March 15, 1984, and before January 1, 1985, the taxpayer will be treated as having satisfied the foreign management tests of section 924(c) for periods before December 31, 1984, and the foreign economic process tests of section 924(d) with respect to costs incurred before December 31, 1984, but only with respect to income attributable to such contract that is recognized before December 31, 1985.

The FSC rules will apply to the income from the long-term contract if an election is made and the general requirements under section 922 are satisfied. However, such taxpayer need not satisfy the activities test under section 925(c) for activities which occur before January 1, 1985 in order to use the transfer pricing rules under section 925.

(11) *Incomplete transactions.*

Q–11: In computing its foreign trade income, how should a FSC treat transfers of export property from a related supplier to a DISC which is subsequently resold by a FSC after the DISC's termination?

A–11: In applying the gross receipts and combined taxable income methods under section 925 (a)(1) and (a)(2), the transaction is treated as if the transfer of export property were made by the related supplier to the FSC except that the foreign management and economic processes tests under section 924 and the activities test under section 925(c) shall be deemed to be satisfied for purposes of the transaction.

(12) *Pre-effective date costs and activities.*

Q–12: Are costs incurred and activities performed prior to January 1, 1985 taken into account for purposes of satisfying the foreign management and foreign economic processes requirements of subsections (c) and (d) of section 924 and the activities test under section 925(c)?

A–12: For purposes of determining the costs incurred and the activities performed to be taken into account with respect to contracts entered into after December 31, 1984, only those costs incurred and activities performed after December 31, 1984, are taken into consideration. Costs incurred and activities performed by a related supplier prior to January 1, 1985 (or prior to the effective date of a corporation's election to be treated as a FSC if other than January 1, 1985) with respect to transactions occurring after January 1, 1985 (or after the effective date of a corporation's election to be treated as a FSC) need not be taken into account for purposes of computing the FSC's profit under section 925 but are treated

for section 925(c) purposes as if they were performed on behalf of the FSC.

(13) *FSC and interest charge DISC.*

Q–13: Can a FSC and an interest charge DISC be members of the same controlled group?

A–13: A FSC and an interest charge DISC cannot be members of the same controlled group. If any controlled group of corporations of which an interest charge DISC is a member establishes a FSC, then any interest charge DISC which is a member of such group shall be treated as having terminated its status as an interest charge DISC.

(c) *Export Trade Corporations*—(1) *Previously taxed income.*

Q–1: Under what circumstances are earnings of an export trade corporation that have not been included in income under section 951 treated as previously taxed income previously included in the income of a U.S. shareholder for purposes of section 959 (and not taxed)?

A–1: A corporation which qualifies as an export trade corporation (ETC) with respect to its last taxable year beginning before January 1, 1985, and elects to discontinue operations as an ETC for all taxable years beginning after December 31, 1984, shall not be required to take into income earnings attributable to previously excluded export trade income, as defined in §1.970–1(b), derived with respect to taxable years beginning before January 1, 1985. However, any amounts distributed by the former ETC (*i.e.* a corporation which was an ETC for its last taxable year beginning before January 1, 1985) shall be treated as being made out of current earnings and profits and then out of previously taxed income. For purposes of determining the shareholder's basis in the ETC stock, distributions of previously excluded export trade income shall be treated as if made out of previously taxed income which has already been included in gross income under section 951(a)(1)(B). Thus, no basis adjustment under section 961 is necessary. In addition, upon the sale or exchange of the stock of such corporation in a transaction described in section 1248(a), the earnings and profits of the corporation attributable to such previously untaxed income shall not be subject to section 1248(a).

(2) *Qualification as an ETC for last year.*

Q–2: Must an ETC satisfy all of the tests set forth in section 971(a)(1) for the ETC's last taxable year beginning before January 1, 1985?

A–2: All of the tests in section 971(a)(1) must be satisfied, except that for purposes of the working capital requirements set forth in section 971(c)(1), the working capital of the ETC at the close of its last taxable year beginning before January 1, 1985 shall be deemed reasonable.

(3) *Continuation of ETC status.*

Q–3: May a corporation which chooses to remain an ETC after December 31, 1984, continue to do so?

A–3: Yes. However, previously untaxed income of such ETC shall not be treated as previously taxed income in accordance with Q&A #1 of this section.

(4) *Discontinuation of ETC status.*

Q–4: How does an ETC make an election to discontinue its operation as an ETC?

A–4: The United States shareholders (as defined in section 951(b)) must file a statement of election on behalf of the ETC indicating the intent of the ETC to discontinue operations as an ETC for taxable years beginning after December 31, 1984. In addition, the statement of election must include the name, address, taxpayer identification number and stock interest of each United States shareholder. The statement must also indicate that the corporation on behalf of which the shareholders are making the election qualified as an ETC for its last taxable year beginning before January 1, 1985, and also the amount of earnings attributable to previously excluded export trade income. The statement must be jointly signed by each United States shareholder with each shareholder stating under penalties of perjury that he or she holds the stock interest specified for such shareholder in the statement of election. A copy of the statement of election must be attached to Form 5471 (information return with respect to a foreign corporation) filed with respect to the ETC's last taxable year beginning before January 1, 1985.

(5) *Transition transfers.*

Q–5: Under what circumstances may an electing ETC transfer its assets to a FSC without incurring any tax liability on the transfer?

A–5: An electing ETC will recognize no income, gain, or loss on a transfer of its assets to a FSC but only if all of the following conditions are met:

(i) The assets transferred were held by the ETC on August 4, 1983, and were transferred by the ETC to the FSC in a transfer completed before January 1, 1986; and

(ii) The assets are transferred in a transaction which would qualify for nonrecognition under subchapter C of chapter 1 of the Code, or would so qualify but for section 367 of the Code.

In such case, section 367 shall not apply to the transfer. In addition, other provisions of subchapter C will apply to the transfer such as section 358 (basis to shareholders), section 362 (basis to corporation) and section 381 (carryovers in corporate acquisitions). In determining whether a transfer by an ETC to a FSC qualifies for nonrecognition under subchapter C, a liquidation of the assets of the ETC into a parent corporation followed by a transfer by the parent of those assets to the FSC will be treated as a transaction described in section 368(a)(1)(D).

(Secs. 803 and 805 of the Tax Reform Act of 1984 (98 Stat. 1001) and sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805); sec. 805 (b)(3)(C) and (D) of the Tax Reform Act of 1984 (98 Stat. 1002), and sec. 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805); secs. 367, 927, and 7805 of the Internal Revenue Code of 1954 (98 Stat. 662, 26 U.S.C. 367; 98 Stat. 663, 26 U.S.C. 367; 98 Stat. 993, 26 U.S.C. 927; 98 Stat. 994, 26 U.S.C. 927; and 68A Stat. 917, 26 U.S.C. 7805); sec. 805 of the Tax Reform Act of 1984 (Pub. L. 98–69, 98 Stat. 1000))

[T.D. 7983, 49 FR 40013, Oct. 12, 1984, as amended by T.D. 7992, 49 FR 48283, Dec. 12, 1984; T.D. 7993, 49 FR 48291, Dec. 12, 1984; T.D. 7992, 49 FR 49450, Dec. 20, 1984; T.D. 8126, 52 FR 6434, 6435, Mar. 3, 1987; T.D. 8515, 59 FR 2984, Jan. 20, 1994; T.D. 8858, 65 FR 1237, Jan. 7, 2000; T.D. 8940, 66 FR 9929, Feb. 13, 2001]

§ 1.921–2 Foreign Sales Corporation—general rules.

(a) *Definition of a FSC and the Effect of a FSC Election.*

Q–1. What is the definition of a Foreign Sales Corporation (hereinafter referred to as a ''FSC'' (All references to FSCs include small FSCs unless indicated otherwise))?

A–1. As defined in section 922(a), an FSC must satisfy the following eight requirements.

(i) The FSC must be a corporation organized or created under the laws of a foreign country that meets the requirements of section 927(e)(3) (a ''qualifying foreign country'') or a U.S. possession other than Puerto Rico (an ''eligible possession''). See Q&As 3, 4, and 5 of § 1.922–1.

(ii) A FSC may not have more than 25 shareholders at any time during the taxable year. See Q&A 6 of § 1.922–1.

(iii) A FSC may not have any preferred stock outstanding during the taxable year. See Q&As 7 and 8 of § 1.922–1.

(iv) A FSC must maintain an office outside of the United States in a qualifying foreign country or an eligible possession and maintain a set of permanent books of account (including invoices or summaries of invoices) at such office. See Q&As 9, 10, 11, 12, 13, 14, and 15 of § 1.922–1.

(v) A FSC must maintain within the United States the records required under section 6001. See Q&A 16 of § 1.922–1.

(vi) The FSC must have a board of directors which includes at least one individual who is not a resident of the United States at all times during the taxable year. See Q&As 17, 18, 19, 20, and 21 of § 1.922–1.

(vii) A FSC may not be a member, at any time during the taxable year, of any controlled group of corporations of which an interest charge DISC is a member. See Q&A 2 of this section and Q&A 13, of § 1.921–1T(b)(13).

(viii) A FSC must have made an election under section 927(f)(1) which is in effect for the taxable year. See Q&A 1 of § 1.921–1T(b)(1) and § 1.927(f)–1.

In addition, under section 441(h), the taxable year of a FSC must conform to the taxable year of its principal shareholder. See Q&A 4 of § 1.921–1T(b)(4).

Q–2. Does the reference to a DISC under section 922(a)(1)(F) which provides that a FSC cannot be a member, at any time during the taxable year, of any controlled group of corporations of