AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

outside the U.S. customs territory. In addition, a FSC may incorporate under the laws of a foreign country that is a party to—

(i) An exchange of information agreement that meets the standards of the Caribbean Basin Economic Recovery Act of 1983 (Code section 274(h)(6)(C)), or

(ii) A bilateral income tax treaty with the United States if the Secretary certifies that the exchange of information program under the treaty carries out the purpose of the exchange of information requirements of the FSC legislation as set forth in section 927(e)(3), if the company is covered under the exchange of information program under subdivision (i) or (ii). The Secretary may terminate the certification. Any termination by the Secretary will be effective six months after the date of the publication of the notice of such termination in the FEDERAL REGISTER.

(e) *Foreign Trade Income.*

Q–8. How is foreign trade income defined?

A–8. Foreign trade income, defined in section 923(b), is gross income of an FSC attributable to foreign trading gross receipts. It includes both the profits earned by the FSC itself from exports and commissions earned by the FSC from products and services exported by others.

(f) *Investment Income and Carrying Charges.*

Q–9. What do the terms ''investment income'' and ''carrying charges'' mean?

A–9.

(i) Investment income means:

(A) Dividends,

(B) Interest,

(C) Royalties,

(D) Annuities,

(E) Rents (other than rents from the lease or rental of export property for use by the lessee outside of the United States);

(F) Gains from the sale of stock or securities,

(G) Gains from future transactions in any commodity on, or subject to the rules of, a board of trade or commodity exchange (other than gains which arise out of a bona fide hedging transaction reasonably necessary to conduct the business of the FSC in the manner in which such business is customarily conducted by others),

(H) Amounts includable in computing the taxable income of the corporation under part I of subchapter J, and

(I) Gains from the sale or other disposition of any interest in an estate or trust.

(ii) Carrying charges means:

(A) Charges that are imposed by a FSC or a related supplier and that are identified as carrying charges, (''stated carrying charges'') and

(B)(*1*) Charges that are considered to be included in the price of the property or services sold by an FSC or a related supplier, as provided under Q&As 1 and 2 of §1.927(d)–1, and

(*2*) Any other unstated interest.

Q–10. How are investment income and carrying charges treated?

A–10. Investment income and carrying charges are not foreign trading gross receipts. Investment income and carrying charges are includable in the taxable income of an FSC, except in the case of a commission FSC where carrying charges are treated as income of the related supplier, and are treated as income effectively connected with a trade or business conducted through a permanent establishment within the United States. The source of investment income and carrying charges is determined under sections 861, 862, and 863 of the Code.

(g) *Small Businesses.*

Q–11. What options are available to small businesses engaged in exporting?

A–11. A small business may elect to be treated as either a small FSC or an interest charge DISC. See Q&As 3 & 4 of §1.921–2 relating to a small FSC. Rules with respect to interest charge DISCs are the subject of another regulations project.

[T.D. 8127, 52 FR 6469, Mar. 3, 1987]

§ 1.921–3T Temporary regulations; Foreign sales corporation general rules.

(a) *Exclusion*—(1) *Classifications of income.* The extent to which income of a FSC (any further reference to a FSC in this section shall include a small FSC unless indicated otherwise) is subject to the corporate income tax of section 11, or, in the alternative, section

1201(a), is dependent upon the allocation of the FSC's income to the following five categories:

(i) Exempt foreign trade income determined under section 923 and §1.923–1T;

(ii) Non-exempt foreign trade income determined with regard to the administrative pricing rules of section 925(a)(1) or (2);

(iii) Non-exempt foreign trade income determined without regard to the administrative pricing rules of section 925(a)(1) or (2) (section 923(a)(2) non-exempt income as defined in section 927(d)(6));

(iv) Investment income and carrying charges; and

(v) Other non-foreign trade income.

(2) *Source and characterization of FSC income*—(i) *Exempt foreign trade income.* The exempt foreign trade income of a FSC determined under section 923 and §1.923–1T is treated as foreign source income which is not effectively connected with a United States trade or business. See §1.923–1T(a) for the definition of foreign trade income and §1.923–1T(b) for the definition of exempt foreign trade income.

(ii) *Non-exempt foreign trade income determined with regard to the administrative pricing rules.* The FSC's non-exempt foreign trade income with respect to a transaction or group of transactions will be treated as United States source income which is effectively connected with the FSC's trade or business which is conducted through its permanent establishment within the United States if either of the administrative pricing rules of section 925(a)(1) or (2) is used to determine the FSC's foreign trade income from a transaction or group of transactions. See §1.923–1T(b) for the definition of non-exempt foreign trade income.

(iii) *Non-exempt foreign trade income determined without regard to the administrative pricing rules.* The source and taxation of the FSC's non-exempt foreign trade income not classified in paragraph (a)(2)(ii) of this section will be determined under the appropriate sections of the Internal Revenue Code and the regulations under those sections. This type of income (section 923(a)(2) non-exempt income) includes both income that is not effectively connected with the conduct of a trade or business in the United States and income that is effectively connected.

(iv) *Investment income and carrying charges.* All of the FSC's investment income and carrying charges will be treated as income which is effectively connected with the FSC's trade or business which is conducted through its permanent establishment within the United States. The source of that income will be determined under the appropriate sections of the Internal Revenue Code and the regulations under those sections. See §1.921–2(f) (Q & A9) for definition of investment income and carrying charges.

(v) *Non-foreign trade income (other than investment income and carrying charges).* The source and taxation of the FSC's non-foreign trade income (other than investment income and carrying charges) will be determined under the appropriate sections of the Internal Revenue Code and the regulations under those sections.

(b) *Allocation and apportionment of deductions.* Expenses, losses and deductions incurred by the FSC shall be allocated and apportioned under the rules set forth in §1.861–8 to the FSC's foreign trade income and to the FSC's non-foreign trade income. Any deductions incurred by the FSC on a transaction, or group of transactions, which are allocated and apportioned to the FSC's foreign trade income from that transaction, or group of transactions, shall be allocated on a proportionate basis between exempt foreign trade income and non-exempt foreign trade income.

(c) *Net operating losses and capital losses*—(1) *General rule.* (i) If a FSC for any taxable year incurs a deficit in earnings and profits attributable to foreign trade income determined without regard to the administrative pricing rules of section 925(a)(1) or (2), that deficit shall be applied to reduce current earnings and profits, if any, attributable to—

(A) First, exempt foreign trade income determined with regard to the administrative pricing rules,

(B) Second, non-exempt foreign trade income determined with regard to the administrative pricing rules,

(C) Third, investment income and carrying charges, and

(D) Fourth, other non-foreign trade income.

(ii) If a FSC for any taxable year incurs a deficit in earnings and profits attributable to non-foreign trade income (other than investment income, carrying charges and net capital losses), that deficit shall be applied to reduce current earnings and profits, if any, attributable to—

(A) First, investment income and carrying charges,

(B) Second, exempt foreign trade income determined with regard to the administrative pricing rules,

(C) Third, exempt foreign trade income determined without regard to the administrative pricing rules,

(D) Fourth, non-exempt foreign trade income determined with regard to the administrative pricing rules, and

(E) Fifth, section 923(a)(2) non-exempt income.

(iii) If a FSC for any taxable year incurs a deficit in earnings and profits attributable to investment income and carrying charges, that deficit shall be applied to reduce current earnings and profits, if any, attributable to—

(A) First, non-foreign trade income other than capital gains,

(B) Second, exempt foreign trade income determined with regard to the administrative pricing rules,

(C) Third, exempt foreign trade income determined without regard to the administrative pricing rules,

(D) Fourth, non-exempt foreign trade income determined with regard to the administrative pricing rules, and

(E) Fifth, section 923(a)(2) non-exempt income.

(iv) Net capital losses will be available for carryback or carryover pursuant to paragraph (c)(2) of this section.

(v) Because the no-loss rules provide that a related supplier may always compensate the FSC for its expenses either as part of the commission payment or as part of the transfer price if the administrative pricing rules are used (see §1.925(a)–1T(e)(1)(i)), a FSC will not have a deficit in its earnings and profits relating to foreign trade income determined with regard to the administrative pricing rules. To determine the amount of any division of earnings and profits for the purpose of determining under §1.926(a)–1T (a) and (b) the treatment and order of distributions, the portion of a deficit in earnings and profits chargeable under this paragraph to such division prior to such distribution shall be determined in a manner consistent with the rules in §1.316–2(b) for determining the amount of earnings and profits available on the date of any distribution.

(2) *Carryback or carryover of net operating losses and capital losses to other taxable years of a FSC (or former FSC).* (i) The amount of the deduction for the taxable year under section 172 for a net operating loss carryback or carryover, or under section 1212 for a capital loss carryback or carryover, shall be determined in the same manner as if the FSC were a foreign corporation which had not elected to be treated as a FSC. Thus, the amount of the deduction will be the same whether or not the corporation was a FSC in the year of the loss or in the year to which the loss is carried.

(ii) Any carryback or carryover of a FSC's (or former FSC's) net operating loss which is attributable to transactions which give rise to foreign trade income shall be charged—

(A) First, to earnings and profits attributable to exempt foreign trade income which is determined without regard to the administrative pricing rules,

(B) Second, to earnings and profits attributable to section 923(a)(2) non-exempt income,

(C) Third, to earnings and profits attributable to exempt foreign trade income determined with regard to the administrative pricing rules,

(D) Fourth, to earnings and profits attributable to non-exempt foreign trade income determined with regard to the administrative pricing rules,

(E) Fifth, to earnings and profits attributable to investment income and carrying charges (other than capital gain income), and

(F) Sixth, to earnings and profits attributable to non-foreign trade income (other than investment income, carrying charges and capital gain income).

(iii) Any carryback or carryover of a FSC's (or former FSC's) net operating

loss which is attributable to non-foreign trade income (other than capital gain income) shall be charged—

(A) First, to earnings and profits attributable to non-foreign trade income (other than investment income, carrying charges and capital gain income),

(B) Second, to earnings and profits attributable to investment income and carrying charges,

(C) Third, to earnings and profits attributable to exempt foreign trade income determined with regard to the administrative pricing rules,

(D) Fourth, to earnings and profits attributable to non-exempt foreign trade income determined with regard to the administrative pricing rules,

(E) Fifth, to earnings and profits attributable to exempt foreign trade income which is determined without regard to the administrative pricing rules, and

(F) Sixth, to earnings and profits attributable to section 923(a)(2) non-exempt income.

(iv) Any carryback or carryover of a net operating loss to a year in which the corporation was (or is) a FSC from a taxable year in which the corporation was not a FSC shall be applied in a manner consistent with subdivision (iii) of this paragraph.

(d) *Credits against tax*—(1) *General rule.* Notwithstanding any other provision of chapter 1, subtitle A, a FSC is allowed under section 921(c) as credits against tax only the following credits:

(i) The foreign tax credit, section 27(a);

(ii) The credit for tax withheld at source on foreign corporations, section 33; and

(iii) The certain uses of gasoline and special fuels credit, section 34.

(2) *Foreign tax credit.* (i) The direct foreign tax credit of section 901(b)(4) as determined under section 906 for income, war profits, and excess profits taxes (or taxes in lieu thereof) paid or accrued to any foreign country or possession of the United States is allowed a FSC only to the extent that those taxes are attributable to the FSC's foreign source non-foreign trade income which is effectively connected with its conduct of a trade or business within the United States. See section 906(b)(5).

(ii) The foreign tax credit for domestic corporate shareholders in foreign corporations (the deemed paid credit) provided under section 901(a) as determined under section 902 is allowed for income, war profits, and excess profits taxes deemed paid or accrued by a FSC (or former FSC) only to the extent those taxes are deemed paid or accrued with respect to the FSC's (or former FSC's) section 923(a)(2) non-exempt income and its non-foreign trade income.

(iii) The foreign tax credit allowed by sections 901 and 903 for tax withheld at source is allowed only to the extent the dividends paid to the FSC's (or former FSC's) shareholder are attributable to the FSC's (or former FSC's) section 923(a)(2) non-exempt income and its non-foreign trade income.

(3) *Foreign tax credit limitation.* (i) For purposes of computation of the direct foreign tax credit of section 901(b)(4) as determined under section 906, the separate limitation of section 904(d)(1)(C) for the FSC's taxable income attributable to its foreign trade income will apply. The direct foreign tax credit is not allowed to a FSC with regard to taxes it paid which are attributable to its foreign trade income. Since the foreign tax credit is not allowed for that type of income, the effect of the separate limitation is to remove the FSC's foreign trade income from the numerator of the fraction used to compute the FSC's overall foreign tax credit limitation.

(ii) A separate limitation under section 904(d)(1)(D) is provided for distributions from a FSC (or former FSC) that arise through operation of the deemed paid credit of section 902 and are attributable to foreign trade income earned during the period when the distributing corporation was a FSC. This limitation is computed by multiplying the FSC's shareholder's tentative United States tax by a fraction the numerator of which is the foreign source dividend (determined with regard to section 78) attributable to the foreign trade income less dividends received deductions and other expenses allocated and apportioned under §1.861–8 allowed to the shareholder and the denominator of which is the shareholder's worldwide income. The effect of this separate limitation is to remove

dividends attributable to the FSC's foreign trade income from the numerator of the fraction used to compute the overall foreign tax credit limitation of the FSC's shareholder.

(iii) The separate limitation under section 904(d)(1)(D) also applies to the foreign tax credit allowed to a FSC shareholder by sections 901 and 903 for tax withheld at source on dividends paid by the FSC. The numerator of this fraction is the part of the dividend attributable to the FSC's foreign trade income and the denominator is the shareholder's worldwide income. The effect of this separate limitation is to remove dividends attributable to foreign trade income of a FSC (or former FSC) from the numerator of the fraction used to compute the overall foreign tax credit limitation of the FSC's shareholder.

(e) *Deduction for foreign income, war profits and excess profits taxes.* Under section 275(a)(4)(B), income, war profits and excess profits taxes imposed by a foreign country or possession of the United States may not be deducted by a FSC to the extent those taxes are paid or accrued with respect to its foreign trade income.

(f) *Payment of estimated tax.* Every FSC which is subject to tax under section 11 or 1201(a) and section 882 must make payment of its estimated tax in accordance with section 6154 and the regulations under that section. In determining the amount of the estimated tax, the FSC must treat the tax imposed by section 881 as though it were a tax imposed by section 11. See section 6154(g).

(g) *Accumulated earnings, personal holding company and foreign personal holding company.* The provisions covering the accumulated earnings tax (sections 531 through 537), personal holding companies (sections 541 through 547) and foreign personal holding companies (sections 551 through 558) apply to FSCs to the extent they would apply to foreign corporations that are not FSCs.

(h) *Subpart F income and increase of earnings invested in U.S. property.* For the mandatory inclusion in the gross income of the U.S. shareholders of the subpart F income and of the increase in earnings invested in U.S. property of a FSC, see sections 951 through 964 and the regulations under those sections. However, the foreign trade income (other than section 923(a)(2) non-exempt income) and, generally, the investment income and carrying charges of a FSC and any deductions which are allocated and apportioned to those classes of income, are not taken into account under sections 951 through 964. See sections 951(e) and 952(b).

(i) *Certain accumulations of earnings and profits.* For the inclusion in the gross income of U.S. persons as a dividend on the gain recognized on certain sales or exchanges of stock in a FSC, to the extent of certain earnings and profits attributable to the stock which were accumulated while the FSC was a controlled foreign corporation, see section 1248 and the regulations under that section. However, section 1248 and the regulations under that section do not apply to a FSC's earnings and profits attributable to foreign trade income, see section 1248(d)(6).

(j) *Limitations on certain multiple tax benefits.* The provisions of section 1561, Limitations on Certain Multiple Tax Benefits in the Case of Certain Controlled Corporations, and section 1563, Definitions and Special Rules, and the regulations under those sections apply to a FSC and its controlled group.

[T.D. 8126, 52 FR 6435, Mar. 3, 1987]

§ 1.922–1 Requirements that a corporation must satisfy to be a FSC or a small FSC.

(a) *FSC requirements.*

Q–1. What are the requirements that a corporation must satisfy to be an FSC?

A–1. A corporation must satisfy all of the requirements of section 922(a).

(b) *Small FSC requirements.*

Q–2. What are the requirements that a corporation must satisfy to be a small FSC?

A–2. A corporation must satisfy all of the requirements of sections 922(a)(1) and (b).

(c) *Definition of corporation.*

Q–3. What type of entity is considered a corporation for purposes of qualifying as an FSC or a small FSC under section 922?

A–3. A foreign entity that is classified as a corporation under section