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(*2*) Multiplying the result by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365.

For purposes of the preceding sentence, section 1563(b) shall be applied as if the last day of the short period were substituted for December 31. Except as provided in subdivision (2)(iii)(B) of this paragraph, the small FSC having a short period not including a December 31 may not enter into an apportionment plan with respect to the short period.

(B) *Exception.* If the short period not including a December 31 of two or more small FSCs begins on the same date and ends on the same date and those small FSCs are members of the same controlled group, those small FSCs may enter into an apportionment plan for such short period in the manner provided in subdivision (2)(i) of this paragraph with respect to the combined amount allowed to each of those small FSCs under subdivision (2)(iii)(A) of this paragraph.

[T.D. 8126, 52 FR 6438, Mar. 3, 1987, as amended by T.D. 9304, 71 FR 76907, Dec. 22, 2006; T.D. 9476, 74 FR 68531, Dec. 28, 2009]

§ 1.924(c)–1 Requirement that a FSC be managed outside the United States.

(a) *In general.* Section 924(b)(1)(A) provides that a FSC shall be treated as having foreign trading gross receipts for the taxable year only if the management of the FSC during the year takes place outside the United States, as provided in section 924(c). Section 924(c) and this section set forth the management activities that must take place outside the United States in order to satisfy the requirement of section 924(b)(1)(A). Paragraph (b) of this section provides rules for determining whether the requirements of section 924(c)(1) have been met. Section 924(c)(1) requires that all meetings of the board of directors of the FSC during the taxable year and all meetings of the shareholders of the FSC during the taxable year take place outside the United States. Paragraph (c) of this section provides rules for maintaining the FSC's principal bank account outside the United States as provided in section 924(c)(2). Paragraph (d) of this section provides rules for disbursements required by section 924(c)(3) to be made from bank accounts of the FSC maintained outside the United States.

(b) *Meetings of board of directors and meetings of shareholders must be outside the United States.* All meetings of the board of directors of the FSC and all meetings of the shareholders of the FSC that take place during a taxable year must take place outside the United States to meet the requirements of section 924(c)(1). Only meetings that are formally convened as meetings of the board of directors or as shareholder meetings will be taken into account in determining whether those requirements have been met. In addition, all such meetings must comply with the local laws of the foreign country or possession of the United States in which the FSC was created or organized. The local laws determine whether a meeting must be held, when and where it must be held (if it is held at all), who must be present, quorum requirements, use of proxies, and so on. Where the local law permits action by the board of directors or shareholders to be taken by written consent without a meeting, use of such procedure will not constitute a meeting for purposes of section 924(c)(1). Section 924(c)(1) and this section impose no other requirements except the requirement that meetings that are actually held take place outside the United States. If the participants in a meeting are not all physically present in the same location, the location of the meeting is determined by the location of the persons exercising a majority of the voting power (including proxies) participating in the meeting. For example, a FSC has five directors, and is organized in country A. Country A's law requires that a majority of the directors of a corporation must participate in a meeting to constitute a quorum (and, thus, a meeting), but there is no requirement that the meeting be held in country A or that the directors must be physically present to participate. One director is in country A, another director is in country B, and a third director is in the United States.

These three directors convene a meeting by telephone that constitutes a meeting under the law of country A.

The meeting occurs outside the United States because the persons exercising a majority of the voting power participating in the meeting are located outside the United States.

(c) *Maintenance of the principal bank account outside the United States*—(1) *In general.* For purposes of section 924(c), the bank account that shall be regarded as the principal bank account of a FSC is the bank account from which the disbursements described in paragraph (d) of this section are made. A FSC may have more than one principal bank account. The bank account that is regarded as the principal bank account must be maintained in a foreign country which meets the requirements of section 927(e)(3), or in any possession of the United States (as defined in section 927(d)(5)), and it must be so maintained at all times during the taxable year. For taxable years beginning on or after February 19, 1987, a principal bank account or accounts must be designated on the annual return of the FSC by providing the bank name(s) and account number(s).

(2) *Maintenance of the account in a bank.* The bank account that is regarded as the principal bank account must be maintained in an institution that is engaged in the conduct of a banking, financing, or similar business, as defined in §1.954–2(d)(2)(ii) (without regard to whether it is a controlled foreign corporation). The institution may be a U.S. bank, provided that the account is maintained in a branch outside the United States.

(3) *Maintenance of an account outside the United States.* Maintenance of the principal bank account outside the United States means that the account regarded as the principal bank account must be an account maintained on the books of the banking institution at an office outside the United States, but does not require that access to the account may be made only outside the United States. Instructions providing for deposits into or disbursements from the account may originate in the United States without affecting the status of maintenance of the account outside the United States.

(4) *Maintenance of the account at all times during the taxable year.* The term ''at all times during the taxable year'' generally means for each day of the taxable year. In the case of a newly created or organized corporation, thirty days may elapse between the effective date of the corporation's election to be treated as a FSC and the date a bank account is opened without causing the FSC to fail the requirement that it maintain its principal bank account outside the United States at all times during the taxable year. For example, if a corporation is created or organized prior to January 1, 1985, and makes an election to be treated as a FSC within the first 90 days of 1985, the election is effective as of January 1, 1985. Thus, the FSC must open a bank account within 30 days of January 1, or as of January 31, 1985, to satisfy this requirement. Also, a FSC shall be treated as satisfying this requirement if the account that is regarded as its principal bank account is terminated during the taxable year, provided that (i) such termination is the result of circumstances beyond the FSC's control, and (ii) the FSC establishes a new principal bank account within thirty days after such termination. A FSC may close its principal bank account and replace it with another account that qualifies under this paragraph (c) as a principal bank account at any time provided that no lapse of time occurs between the closing of the principal bank account and the opening of the replacement account.

(5) *Other accounts.* The FSC may maintain other bank accounts in addition to its principal bank account. Such other accounts may be located anywhere, without limitation. The mere existence of such other accounts will not cause the FSC to fail to satisfy the requirements of section 924(c).

(d) *Disbursement of dividends, legal and accounting fees, and salaries of officers and directors out of the principal bank account of the FSC*—(1) *In general.* All dividends, legal fees, accounting fees, salaries of officers of the FSC, and salaries or fees paid to members of the board of directors of the FSC that are disbursed during the taxable year must be disbursed out of bank account(s) of the FSC maintained outside the United States. Such an account is treated as the principal bank account of the FSC

for purposes of section 924(c). Dividends, however, may be netted against amounts owed to the FSC (e.g., commissions) by a related supplier through book entries. If the FSC regularly disburses its legal or accounting fees, salaries of officers, and salaries or fees of directors out of its principal bank account, the occasional, inadvertent payment by mistake of fact or law of such amounts out of another bank account will not be considered a disbursement by the FSC if, upon determination that such payment was made from another account, reimbursement to such other account is made from the principal bank account of the FSC within a reasonable period from the date of the determination. Disbursement out of the principal bank account of the FSC may be made by transferring funds from the principal bank account to a U.S. account of the FSC provided that (i) the payment of the dividends, salaries or fees to the recipients is made within 12 months of the transfer, (ii) the purpose of the expenditures is designated and, (iii) the payment of the dividends, salaries or fees is actually made out of the same U.S. account that received the disbursement from the principal bank account.

(2) *Reimbursement.* Legal or accounting fees, salaries of officers, and salaries or fees of directors that are paid by a related person wholly or partially on behalf of a FSC must be reimbursed by the FSC. The amounts paid by the related person are not considered disbursed by the FSC until the related person is reimbursed by the FSC. The related person must be reimbursed no later than the last date prescribed for filing the FSC's tax return (including extensions) for the taxable year to which the reimbursement relates. Any reimbursement for amounts paid on behalf of the FSC must be disbursed out of the FSC's principal bank account (and not netted against any obligation owed by the related person to the FSC), as set forth in paragraph (c) of this section. To determine the amounts paid on behalf of the FSC, the FSC may rely upon a written statement or invoice furnished to it by the related person which shows the following:

(i) The actual fees charged for performing the legal or accounting services for the FSC or, if such fees cannot be ascertained by the related person, a good faith estimate thereof, and the actual salaries or fees paid for services as officers and directors of the FSC, and

(ii) The person who performed or provided the services.

(3) *Good faith exception.* If, after the FSC has filed its tax return, a determination is made by the Commissioner that all or a part of the legal or accounting fees, salaries of officers, and salaries or fees of directors of the FSC were paid by a related person without receiving reimbursement, the FSC may, nonetheless, satisfy the requirements of section 924(c)(3) if the fees and salaries were paid by the related person in good faith, and the FSC reimburses the related person for the fees and salaries paid within 90 days after the determination. The reimbursement shall be treated as made as of the end of the taxable year of the FSC for which the reimbursement is made.

(4) *Dividends*—(i) *Definition.* For purposes of section 924(c) and this section only, the term ''dividends'' refers solely to cash dividends (including a dividend paid in a foreign functional currency) actually paid pursuant to a declaration or authorization by the FSC. Accordingly, a ''dividend'' will not include a constructive dividend that is deemed to be paid (regardless of the source of such constructive dividend) or a distribution of property that is a dividend under section 316 other than a distribution of U.S. dollars or a foreign functional currency.

(ii) *Offset accounting entries.* Payment of dividends by the FSC to its related supplier may be in the form of an accounting entry offsetting an amount payable to the related supplier for the dividend against an existing debt owed to the FSC. The offset accounting entries must be clearly identified in the books of account of both the related supplier and the FSC.

(5) *Legal and accounting fees.* For purposes of this section, legal and accounting fees do not include salaries paid to legal and accounting employees of the FSC (or a related person). Legal and accounting fees are limited to fees paid to independent persons performing legal or accounting services for or with respect to the FSC.

(6) *Salaries of officers and directors.* For purposes of this section, salaries of officers and salaries or fees of directors are only those salaries or fees paid for services as officers or directors of the FSC. Salaries do not include reimbursed travel and entertainment expenses. If an individual officer, director, or employee of a related person is also an officer or director of a FSC and receives additional compensation for services performed for the FSC, the portion of the compensation paid to the individual which is for services performed for the FSC is required to be disbursed out of the FSC's principal bank account. For purposes of this section, the term ''compensation'' is defined as set forth §1.415(c)–2(b) and (c).

[T.D. 8125, 52 FR 5089, Feb. 19, 1987, as amended by T.D. 9319, 72 FR 16894, Apr. 5, 2007]

§ 1.924(d)–1 Requirement that economic processes take place outside the United States.

(a) *In general.* Section 924(b)(1)(B) provides that a FSC has foreign trading gross receipts from any transaction only if economic processes with respect to such transaction take place outside the United States as provided in section 924(d). Section 924(d) and this section set forth the rules for determining whether a sufficient amount of the economic processes of a transaction take place outside the United States. Generally, a transaction will qualify if the FSC satisfies two different requirements: Participation outside the United States in the sales portion of the transaction, and satisfaction of either the 50-percent or the 85-percent foreign direct cost test. The activities comprising these economic processes may be performed by the FSC or by any other person acting under contract with the FSC. (All references to ''FSC'' in §§1.924(d)–1 and 1.924(e)–1 shall mean the FSC or, if applicable, the person performing the relevant activity under contract on behalf of the FSC.) The FSC may act upon standing instructions from another person in the performance of any activity, whether a sales activity under paragraph (c) of this section or an activity relating to the disposition of export property under paragraph (d) of this section and §1.924(e)–1. The identity of the FSC as a separate entity is not required to be disclosed in the performance of any of the activities comprising the economic processes. Except as otherwise provided, the location of any activity is determined by the place where the activity is initiated by the FSC, and not by the location of any person transmitting instructions to the FSC.

(b) *Activities performed by another person*—(1) *In general.* Any person, whether domestic or foreign, and whether related or unrelated to the FSC, may perform any activity required to satisfy this section, provided that the activity is performed pursuant to a contract for the performance of that activity on behalf of the FSC. Such a contract may be any oral or written agreement which constitutes a contract at law. The person performing the activity is not required to enter into a contract directly with the FSC and, thus, may be a direct or indirect subcontractor of a person under contract with the FSC. For example, assume that a buy-sell FSC enters into an agreement with its related supplier in which the related supplier agrees to perform on behalf of the FSC all sales activities with respect to the FSC's transactions with its foreign customers. Through its existing agreements with a domestic unrelated person, the related supplier subcontracts the performance of these activities to the domestic unrelated person, who, in turn, subcontracts the performance of the sales activities to foreign sales agents. The sales activities performed by the foreign sales agents are considered to be performed on behalf of the FSC for purposes of meeting the requirements of section 924(d)(1)(A).

(2) *Proof of compliance.* If the FSC does not perform the activity itself, it must maintain records adequate to establish, with respect to each transaction or group of transactions, that the activity was performed and that the performance of such activity took place outside the United States. If the person who performed the activity on behalf of the FSC is an independent contractor, the FSC may rely upon a written declaration from that person stating that the activities were performed by that person on behalf of the FSC, and were performed outside the