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(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

United States. An invoice or a receipt for payment will be considered to be such a written declaration if it specifies that the activities were performed outside the United States or specifies a particular place outside the United States where the activities were performed. If the person performing the activities on behalf of the FSC is a related person, the FSC must maintain records adequate to establish that the activities were actually performed and where the activities were performed. Such records may be stored with the related person provided that the FSC makes such records available to the Commissioner upon request.

(c) *Participation outside the United States in the sales portion of the transaction*—(1) *In general.* The requirement of section 924(d)(1)(A) is met with respect to the gross receipts of a FSC derived from any transaction if the FSC has participated outside the United States in the solicitation, the negotiation, or the making of the contract relating to such transaction (hereinafter described as ''sales activities''), as provided in this paragraph (c). A sale need not occur in order that the solicitation or negotiation tests be satisfied. Once the FSC has participated outside the United States in an activity that constitutes the solicitation, negotiation, or the making of the contract with respect to a transaction, any prior or subsequent activity by the FSC with respect to such transaction that would otherwise constitute the sales activity will be disregarded for purposes of determining whether the FSC has met the requirements of section 924(d)(1)(A). For example, if a FSC sells a product to a foreign customer by first meeting with the customer in New York to discuss the product and then by mailing to it from outside the United States a brochure describing the product, the prior meeting is disregarded and only the mailing is considered in determining whether there was solicitation outside the United States by the FSC with respect to the transaction which has occurred.

(2) *Solicitation (other than advertising).* For purposes of this paragraph (c), ''solicitation'' refers to any communication (by any method, including, but not limited to, telephone, telegraph, mail, or in person) by the FSC, at any time during the 12 month period (measured from the date the communication is mailed or transmitted) immediately preceding the execution of a contract relating to the transaction to a specific, targeted customer or potential customer, that specifically addresses the customer's attention to the product or service which is the subject of the transaction. For purposes of paragraph (c)(2) of this section, communication by mail means depositing the communication in a mailbox. Except as provided in §1.924(e)–1(a)(1) with respect to second mailings, activities that would otherwise constitute advertising (such as sending sales literature to a customer or potential customer) will be considered solicitation if the activities are directed at a specific, targeted customer or potential customer, and the costs of the activity are not taken into account as advertising under the foreign direct cost tests. Activities that would otherwise constitute sales promotion (such as a promotional meeting in person with a customer) will be considered to be solicitation if the activities are directed at a specific, targeted customer or potential customer, and the costs of the activity are not taken into account as sales promotion under the foreign direct cost tests. Except as provided in §1.924(e)–1(a)(1) with respect to second mailings, the same or similar activities cannot be considered both solicitation and advertising, or both solicitation and sales promotion, with respect to the same customer. Solicitation, however, may take place at the same time as, and in conjunction with, another sales activity. Additionally, it may take place with respect to any person, whether domestic or foreign, and whether or not related to the FSC.

(3) *Negotiation.* For purposes of this paragraph (c), ''negotiation'' refers to any communication by the FSC to a customer or potential customer aimed at an agreement on one or more of the terms of a transaction, including, but not limited to, price, credit terms, quantity, or time or manner of delivery. For purposes of this paragraph (c)(3), communication by mail has the same meaning as provided in paragraph (c)(2) of this section. Negotiation does

not include the mere receipt of a communication from a customer (such as an order) that includes terms of a sale. Negotiation may take place at the same time as, and in conjunction with, another sales activity. Additionally, it may take place with respect to any person, whether domestic or foreign, and whether or not related to the FSC.

(4) *Making of a contract.* For purposes of this paragraph (c), ''making of a contract'' refers to performance by the FSC of any of the elements necessary to complete a sale, such as making an offer or accepting an offer. A requirements contract is considered an open offer to be accepted from time to time when the customer submits an order for a specified quantity. Thus, the acceptance of such an order will be considered the making of a contract. The written confirmation by the FSC to the customer of the acceptance of the open order will also be considered the making of a contract. Acceptance of an unsolicited bid or order is considered the ''making of a contract'' even if no solicitation or negotiation occurred with respect to the transaction. The written confirmation by the FSC to the customer of an oral or written agreement which confirms variable contract terms, such as price, credit terms, quantity, or time or manner of delivery, or specifies (directly or by cross-reference) additional contract terms will be considered the making of a contract. A written confirmation is any confirmation expressed in writing, including a telegram, telex, or other similar written communication. The making of a contract may take place at the same time as, and in conjunction with, another sales activity. Additionally, it may take place with respect to any person, whether domestic or foreign, and whether or not related to the FSC.

(5) *Grouping transactions.* Generally, the sales activities under this paragraph (c) are to be applied on a transaction-by-transaction basis. By annual election of the FSC, however, any of the sales activities may be applied on the basis of a group as set forth in this paragraph (c)(5). Any groupings used must be supported by adequate documentation of performance of activities relating to the groupings used. An election by the FSC to group transactions must be made on its annual income tax return. The FSC, however, may amend its tax return to group in a manner different from that elected on its original return before the expiration of the statute of limitations.

(i) *Standards of groups.* A determination by a FSC as to a grouping will be accepted by a district director if such determination conforms to any of the following standards:

(A) *Product or product line groupings.* A product or product line grouping may be based upon either a recognized trade or industry usage, or upon a two digit major group (or on any inferior classification or combination of inferior classifications within a major group) of the Standard lndustrial Classification as prepared by the Statistical Policy Division of the Office of Management and Budget, Executive Office of the President. For taxable years beginning on or before February 19, 1987, any sales activity that is performed outside the United States with respect to any transaction covered by the product or product line grouping during the FSC's taxable year shall apply to all transactions covered by the product or product line. However, for taxable years beginning after February 19, 1987, the requirement of section 924(d)(1)(A) is met with respect to all transactions covered by the product or product line grouping only if the sales activities are performed outside the United States with respect to customers with sales representing either:

(i) 20 percent or more of the foreign trading gross receipts of the product or product line grouping during the current year or

(ii) 50 percent or more of the foreign trading gross receipts of the product or product line grouping for the prior year irrespective of whether any sales occurred within the current year to the prior year customers.

If during the prior taxable year, the controlled group of which the FSC is a member had a DISC or interest charge DISC, the FSC may use the 50 percent rule with respect to the preceding DISC or interest charge DISC year, substituting qualified export receipts for foreign trading gross receipts. A corporation which has not been treated in

the prior year as a FSC, interest charge DISC, or DISC does not have to meet either the 20 percent test or the 50 percent test for the first year in which it is treated as a FSC.

(B) *Customer groupings.* A customer grouping includes all transactions of the FSC with a particular customer during the FSC's taxable year. Thus, any sales activity that is performed outside the United States with respect to any transaction with the customer during the taxable year shall apply to all transactions within the customer grouping.

(C) *Contract groupings.* A contract grouping includes all transactions of the FSC under a particular contract for a taxable year. Thus, any sales activity that is performed outside the United States with respect to any transaction under the contract will apply to all transactions under the contract for such taxable year. For long-term contracts between unrelated parties, the sales activities tests need be satisfied only once for the life of the contract. With respect to requirements contracts and long-term contracts between related parties, the sales activities test must be satisfied annually.

(D) *Product or product line groupings within customer or contract groupings.* Groupings may be based upon product or product line groupings within customer or contract groupings. If, however, the primary grouping is a customer or contract grouping, the 20 percent test set forth in subdivision (A) of this paragraph relating to product or product line grouping will not be applicable.

(ii) *Transactions included in a grouping.* A choice by a FSC to group transactions shall generally apply to all transactions within the scope of that grouping. The choice of a grouping, however, applies only to transactions covered by the grouping and, for transactions not encompassed by the grouping, the determinations may be made on a transaction-by-transaction basis or other grouping basis. For example, a FSC may choose a product grouping with respect to one product and use the transaction-by-transaction method for another product within the same taxable year. In addition, if a FSC applies sales activity rules on the basis of other types of groupings, such as all sales to a particular customer, transactions included in those other groupings shall be excluded from product groupings.

(iii) *Different groupings allowed for different purposes.* A choice by the FSC to group transactions may be made separately for each of the sales activities under section 924(d)(1)(A). Groupings used for purposes of section 924(d)(1)(A) will have no relationship to groupings used for other purposes, such as satisfying the foreign direct cost tests. This paragraph (c)(5) does not apply for purposes of section 925.

(6) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples:

Example 1. In November, a calendar year FSC mailed from its foreign office its catalog to a potential foreign customer. The catalog displayed numerous products along with a brief description and the price of each. In February of the following year, the FSC sold to the customer a product displayed in the catalog. Since the FSC communicated with the customer during the 12-month period prior to the sale, although during the previous taxable year, the FSC participated outside the United States in the solicitation relating to the transaction.

Example 2. A FSC with a taxable year ending April 30, 1986, solicits customer X during that taxable year with respect to Product A. In the previous taxable year, the FSC sold product A to customers V, W, X, Y, Z, none of whom were customers in the taxable year ending April 30, 1986. The sales proceeds from sales to customer X represented 50 percent of the foreign trading gross receipts for the previous FSC year. The FSC meets the 50 percent test for product or product line grouping for the taxable year ending April 30, 1986. If the facts were changed so that there was not a FSC, DISC or interest charge DISC in the same controlled group in the previous taxable year, the single solicitation directed to any customer would qualify all transactions within the product group as meeting the solicitation requirement for that taxable year. For subsequent taxable years, the 50 percent test or the 20 percent test would be applicable.

Example 3. A FSC earns commissions on the sale of export property by its domestic related supplier to United States wholesalers for final sale to foreign customers. The related supplier receives an order from one of its United States wholesalers. The related supplier telephones the United States wholesaler to inform it of the new price and the probability of another price increase soon. The United States wholesaler orally agrees

to the new price and the related supplier instructs the FSC to telex the wholesaler from its foreign office a confirmation that the product will be sold at the current new price. The written confirmation by the FSC of an oral agreement on a variable contract term constitutes the making of a contract. Thus, the requirements of section 924(d)(1)(A) are met with respect to the transaction relating to the product.

(d) *Satisfaction of either the 50-percent or the 85-percent foreign direct cost test*—(1) *In general.* Section 924(d)(1)(B) requires, in order for the gross receipts of a transaction to qualify as foreign trading gross receipts, that the foreign direct costs incurred by the FSC attributable to the transaction equal or exceed 50 percent of the total direct costs incurred by the FSC attributable to the transaction. The direct costs are those costs attributable to activities described in the five categories of section 924(e). Section 924(d)(2) provides that, instead of satisfying the 50-percent foreign direct cost test of section 924(d)(1)(B), the FSC may incur foreign direct costs attributable to activities described in each of two of those categories that equal or exceed 85 percent of the total direct costs incurred by the FSC attributable to the activity described in each of the two categories. If no direct costs are incurred by the FSC in a particular category, that category shall not be taken into account for purposes of determining satisfaction of either the 50-percent or the 85-percent foreign direct cost test. If any amount of direct costs is incurred in a particular category, that category shall be taken into account for purposes of the foreign direct costs tests.

(2) *Direct costs*—(i) *Definition of direct costs.* For purposes of section 924 (d), direct costs are those costs which are incident to and necessary for the performance of any activity described in section 924(e). Direct costs include the cost of materials which are consumed in the performance of the activity, and the cost of labor which can be identified or associated directly with the performance of the activity (but only to the extent of wages, salaries, fees for professional services, and other amounts paid for personal services actually rendered, such as bonuses or compensation paid for services on the basis of a percentage of profits). Direct costs also include the allowable depreciation deduction for equipment or facilities (or the rental cost for use thereof) that can be specifically identified or associated with the activity, as well as the contract price of an activity performed on behalf of the FSC by a contractor. If costs of services or the use of facilities are only incidentally related to the performance of an activity described in section 924(e), only the incremental cost is considered to be identified directly with the activity. For example, supervisory, administrative, and general overhead expenses, such as telephone service, normally are not identified directly with particular activities described in section 924(e). The cost of a long distance telephone call made to arrange for delivery of export property, however, is identified directly with the activities described in section 924(e)(2). Direct costs for purposes of section 924(d) do not necessarily include all of the expenses taken into account for purposes of determining the taxable income of the FSC or the combined taxable income of the FSC and its related supplier.

(ii) *Allocation of direct costs.* For purposes of this section only, if costs are identified with more than one activity (whether or not all of the activities are described in section 924(e)), the portion of the costs attributable to each activity shall be determined by allocating the costs among the activities in any manner that is consistently applied and, if applicable, that reasonably reflects relative costs that would be incurred by performing each activity independently. If costs of an activity are attributable to more than one transaction or grouping of transactions, the portion of the costs attributable to each transaction or grouping shall be determined by allocating the costs among the transactions or groupings in any manner that is consistently applied and, if applicable, that reasonably reflects relative costs that would be incurred by performing the activity independently with respect to each transaction or grouping.

(3) *Total direct costs.* The term ''total direct costs'' means all of the direct costs of any transaction attributable to activities described in any paragraph of section 924(e). For purposes of

the 50-percent foreign direct cost test of section 924(d)(1)(B), total direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For purposes of the 85-percent foreign direct cost test of section 924(d)(2), however, the total direct costs are determined separately for each paragraph of section 924(e). If more than one activity is included within a paragraph of section 924(e), direct costs must be incurred with respect to at least one activity listed in the paragraph. If costs are incurred with respect to more than one activity, all direct costs must be considered for purposes of satisfying the direct costs test.

(4) *Foreign direct costs.* The term ''foreign direct costs'' means the portion of the total direct costs of any transaction which is attributable to activities performed outside the United States. For purposes of the 50-percent foreign direct cost test, foreign direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For purposes of the 85-percent foreign direct cost test, however, foreign direct costs are determined separately for each paragraph of section 924(e).

(5) *Fifty percent foreign direct cost test.* To satisfy the requirement of section 924(d)(1)(B), the foreign direct costs incurred by the FSC attributable to the transaction must equal or exceed 50 percent of the total direct costs attributable to the transaction. This test looks to the cost of the activities described in section 924(e) on an aggregate basis; therefore, it is not necessary that the foreign direct costs of each activity, or of each paragraph of section 924(e), equal or exceed 50 percent of the total direct costs of that activity or paragraph.

(6) *Eighty-five percent foreign direct cost test*—(i) *General rule.* To satisfy the requirement of section 924(d)(2), the foreign direct costs of a transaction incurred by the FSC attributable to activities described in each of at least two paragraphs of section 924(e) must equal or exceed 85 percent of the total direct costs attributable to activities described in that paragraph. This test looks to costs of the activities on a paragraph-by-paragraph basis (but not on an activity-by-activity basis). As an example, the foreign direct costs of advertising and sales promotion are aggregated with each other for this purpose, but they are not aggregated with the foreign direct costs of transportation.

(ii) *Satisfaction of the 85-percent test.* If, after the FSC files its tax return indicating that it has satisfied the 85-percent foreign direct cost test with respect to each of at least two paragraphs of subsection 924(e) and a determination is made by the Commissioner that the foreign direct costs attributable to one or both of the two paragraphs of section 924(e) specified on the return did not equal or exceed 85 percent of the total direct costs attributable to such activities, the FSC may, nonetheless, satisfy the 85-percent foreign direct cost test if the foreign direct costs attributable to any two paragraphs of section 924 (e) equal or exceed 85 percent of the total direct costs attributable to those other paragraphs.

(e) *Grouping transactions.* Generally, the foreign direct cost tests under paragraph (d) of this section are to be applied on a transaction-by-transaction basis. By annual election of the FSC, however, the foreign direct cost tests may be applied on a customer, contract or product or product line grouping basis. Any groupings used must be supported by adequate documentation of performance of activities and costs of activities relating to the groupings used. An election by the FSC to group transactions must be made on its annual income tax return. The FSC may, however, amend its tax return before the expiration of the statute of limitations under section 6501 of the Code to group in a manner different from that elected on its original return.

(1) *Standards for groupings.* A determination by a FSC as to a grouping will be accepted by the district director if such determination conforms to any of the following standards:

(i) *Product or product line groupings.* A product or product line grouping may be based either on a recognized trade or industry usage, or on a two digit major

grouping (or on any inferior classification or combination of inferior classifications within a major grouping) of the Standard Industrial Classification as prepared by the Statistical Policy Division of the Office of Management and Budget, Executive Office of the President.

(ii) *Customer groupings.* A customer grouping includes all transactions of the FSC with a particular customer during the FSC's taxable year.

(iii) *Contract groupings.* A contract grouping includes all transactions of the FSC under a particular contract, including a requirements contract. The tests will be applied to all transactions within a contract grouping during each taxable year of the FSC; however, by election of the FSC, all transactions under a contract that occur in the first or the last year of the contract may be included with, respectively, the next succeeding or the immediately preceding taxable year in applying these tests. For example, if with respect to transactions during the first calendar year of a 5-year contract, a calendar year FSC incurs direct costs attributable to the transactions of $100X for advertising, all of which are foreign direct costs, and $10X for processing of customers orders and for arranging for delivery, $9X (or 90 percent of the total direct costs) of which are foreign direct costs, the FSC has satisfied the 85-percent foreign direct cost test with respect to those transactions for the taxable year. If with respect to transactions during the second year of the contract, the FSC only incurs $18X of direct costs for processing of customer orders and arranging for delivery, $15X (83.3 percent of the total direct costs) of which are foreign direct costs, the FSC may include the transactions from the first year of the contract to meet the 85-percent foreign direct cost test in the second taxable year. Thus, with respect to the transactions in the second year, the FSC satisfies the foreign direct costs test for advertising (because the entire $100X of direct costs are foreign direct costs) and for processing of customer orders and arranging for delivery (because of the $28X of direct costs, $24X or 85.7 percent of the total direct costs are foreign direct costs). If, however, with respect to transactions in the third year, the FSC satisfies the foreign direct costs test, those transactions cannot be included with the transactions in the fourth year. The FSC may aggregate the direct costs in the fourth and fifth years in the same manner as for the first and second years as described above in order to satisfy the 85 percent foreign direct costs test.

(iv) *Product or product line groupings within customer or contract groupings.* Groupings may be based on product or product line groupings within customer or contract groupings.

(2) *Transactions included in a grouping.* An election by the FSC to group transactions shall generally apply to all transactions within the scope of that grouping. The election of a grouping, however, applies only to transactions covered by the grouping and, as to transactions not encompassed by the grouping, the determinations may be made on a transaction-by-transaction basis or other grouping basis. For example, the FSC may elect a product grouping with respect to one product and elect the transaction-by-transaction method for another product within the same taxable year. In addition, if a FSC is permitted to apply either the 50-percent or the 85-percent foreign direct cost test on the basis of other types of groupings, such as all transactions with respect to a particular customer, transactions included in those other groupings shall be excluded from product groupings.

(3) *Different groupings allowed for different purposes.* An election by the FSC to group transactions may be made separately for each of the activities relating to disposition of export property under section 924(d)(1)(B) or section 924(d)(2). Groupings used for purposes of section 924 will have no bearing on groupings for other purposes. This paragraph (e) does not apply for purposes of section 925.

(f) *Exception for foreign military property*—(1) *General rule.* The requirements of this section do not apply to any activities performed in connection with foreign military sales except those activities described in section 924(e). The FSC is deemed to have satisfied the requirements of section 924(d)(1)(A).

(2) *Example.* The principles of paragraph (f)(1) of this section may be illustrated by the following example:

Example. A FSC earns commissions on foreign military sales by its related supplier. All solicitation, negotiation, and contract making activities occur in the United States solely between the related supplier and the United States government. The property is delivered, title passes, and payment is made in the United States in accordance with standard United States government practices. The FSC incurs direct costs in the amount of $155X to process the government's orders and arrange for delivery of the goods, all of which are foreign direct costs. In addition, it incurs foreign direct costs in the amount of $250X for assembling and transmitting its final invoice to the government from outside the U.S. and foreign direct costs of $200X associated with receiving payment from the related supplier in accordance with the rules of §1.924(e)–1(d)(2)(iii). No other activities occur with respect to the foreign military sales. The FSC has satisfied the 85-percent foreign direct cost test and thus has foreign trading gross receipts with respect to the foreign military sales. The fact that the FSC did not participate outside the United States in any of the sales activities has no bearing on the qualification of the receipts since the FSC is deemed to have met the requirements of section 924(d)(1)(A).

[T.D. 8125, 52 FR 5090, Feb. 19, 1987]

§ 1.924(e)–1 Activities relating to the disposition of export property.

(a) *Advertising and sales promotion.* For purposes of section 924(e), advertising and sales promotion are defined as follows.

(1) *Advertising*—(i) *Advertising defined*—(A) *General rule.* Advertising means the announcement or description of property or services described in section 924(a), in some medium of mass communication (such as radio, television, newspaper, trade journals, mass mailings, or billboards), in order to induce multiple customers or potential customers to buy or rent the property or services from the FSC or related supplier. Advertising is not required to be directed to the general public, but may be focused toward any group of export customers or potential export customers. Advertising except for the advertising described in §1.924(e)–1(a)(1)(B) must describe one or more specific products or product lines (or services) and identify the product as a product offered by the FSC or related supplier. Advertising intended solely to build a favorable image of a company or group of companies is not included in this definition of advertising. Additionally, advertising primarily directed at customers or potential customers in the United States is not included in this definition of advertising, nor is advertising related to property or services not described in section 924(a).

(B) *Special rules for sales to distributors.* If the customer is a distributor (whether domestic or foreign, related or unrelated to the FSC), an expense that is incurred by the distributor and charged to the FSC or related supplier as a reduction in the purchase price or as a separate charge for an announcement or description described in paragraph (a)(1)(A) of this section to induce the distributor's customers, potential customers, or the ultimate users to buy or rent the property or services is advertising for these purposes (i) if the FSC incurs 20 percent or more of the total advertising costs of the distributor or (ii) if the FSC pays the total charge of an advertisement either directly or indirectly. For these purposes, a distributor is anyone other than an end user or a final consumer. A FSC may incur direct advertising costs to a foreign end consumer even though the FSC sells to a U.S. distributor.

(ii) *Direct costs of advertising.* Direct costs of advertising include costs of transmitting, displaying, or distributing the advertising to customers or potential customers and the costs of printing in the case of sales literature, but do not include fees paid to an independent advertising agency to develop the announcement or description, translation costs, or costs of preparing the announcement or description for potential use as advertising. Direct costs of sending sales literature to customers or potential customers may be taken into account as advertising costs as long as the activity is not taken into account for purposes of the sales activity requirements of §1.924(d)–1(c).

(iii) *Location of advertising*—(A) *General rule.* The location of advertising activity is the place to which the advertising is transmitted, displayed, distributed, mailed, or otherwise conveyed to the customers or potential