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(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

customers (or in the case of advertising described in paragraph (a)(i)(B) of this section, the distributor's customers, or the ultimate users). For example, a television advertisement that is broadcast to a foreign country constitutes advertising activity outside the United States even though the broadcast signal originates in the United States. Therefore, the cost of that advertising activity is a foreign cost. The FSC may rely upon the distribution statistics of the publisher of print media or the broadcaster of broadcast media through which the advertising is distributed. If the distribution statistics show that 85 percent or more of the readership, radio listeners, or viewership are outside the United States, all direct costs of advertising are considered foreign direct costs of advertising.

(B) *Foreign editions of journals, magazines, etc.* Costs related to advertising in foreign English editions of U.S. publications as well as advertising in any publication in a foreign language are foreign direct costs.

(C) *United States editions.* Costs related to advertising in United States publications are not treated as direct costs even if the publication also has a foreign edition in English.

(iv) *Second mailings.* In general, direct costs of sending sales literature to customers may be treated as solicitation or advertising, but not both. A distinction may be made, however, between a first and second mailing so that one may be treated as advertising and the other may be treated as solicitation. To qualify under this second mailing rule, the two mailings must be generically different items such as a price list and a description of the product itself. An amended price list would not be distinguishable from an original price list and would, therefore, not constitute a second mailing.

(v) *Examples.* The principles of paragraph (a)(1) of this section may be illustrated by the following examples:

Example 1. The related supplier, under contract with a buy-sell FSC to advertise export product D on the ''FSC's'' behalf to its foreign unrelated customers, engaged a French advertising agency to develop an advertising campaign to induce French customers to buy the product. As a part of the advertising campaign, the agency places a one-page advertisement in a relevant French trade journal. The advertisement constitutes advertising within the meaning of paragraph (a)(1) of this section.

Example 2. A United States weekly magazine publishes, in addition to its United States edition, a Canadian edition in English and a Mexican edition in Spanish. A FSC incurs costs of $200 X for a one-page display in each of the three editions for a total advertising cost of $600 X. The $200 X cost relating to the advertising in the United States edition is not a direct cost because it relates to United States sales. The total costs of $400 X relating to advertising in the English language Canadian edition and the Spanish language Mexican edition are foreign direct costs.

Example 3. A FSC earns commissions on the sale of export product E by its domestic related supplier to United States distributors for resale to Canadian retail customers. The related supplier, under contract with the FSC to advertise product E, pays an amount equal to 1 percent of its annual gross receipts with respect to product E under a cooperative advertising arrangement with the distributor. The amount, which represents 20 percent of the total advertising costs for product E, is reimbursed by the FSC. The 20-percent amount represents a significant portion of the total advertising costs and thus constitutes advertising within the meaning of paragraph (a)(1)(i) of this section.

Example 4. A FSC mails two items to each customer on its customer list within one taxable year. The first mailing consists of a price list which merely lists the various products by name and provides a price next to each product name. The second mailing consists of a brochure which fully describes and illustrates each product. The two mailings are generically different. Therefore, one mailing may be counted as advertising while the other mailing may be counted as solicitation.

(2) *Sales promotion*—(i) *Sales promotion defined.* Sales promotion means an appeal made in person to an export customer or potential export customer for the sale or rental of property or services described in section 924(a), made in the context of a trade show or customer meeting. A customer meeting means a periodic meeting (*e.g.*, quarterly, semi-annual, or annual) in which 10 or more customers or potential customers are reasonably expected to attend. However, for taxable years beginning before February 19, 1987, a customer meeting may, at the option of the taxpayer, mean any meeting with a customer or potential customer regardless of the frequency of the meetings or

the number of customers or potential customers in attendance. A meeting, show or event in the United States that is primarily aimed at the export of goods or services described in section 924(a) constitutes sales promotion. Sales promotion does not include an appeal made in the context of any meeting, show or event primarily aimed at U.S. customers or an appeal for the sale or rental of property or services not described in section 924(a). Whether any meeting, show or event is primarily aimed at U.S. customers or at the export of goods or services described in section 924(a) shall be determined by all of the facts and circumstances including the announced objective of the meeting, show or event; the attendees; the location of the meeting, show or event; and the product or special feature of the product.

(ii) *Direct costs of sales promotion.* Direct costs of sales promotion include costs such as rental of space at trade shows, payments to organizers or other persons hired for the event, rental of display equipment and decorations for the event, and costs of maintaining a showroom. Direct costs of sales promotion also include costs for travel, meals, and lodging for direct sales people attending the event if these costs are paid by the FSC or related supplier. In the case of a customer meeting, direct costs of sales promotion include the costs of materials printed specifically for the meeting and the costs of travel, lodging, and food for both the direct sales people and customers or potential customers attending the meeting. Direct costs of sales promotion do not include the cost of salaries and commissions of direct sales people or the cost of discount coupons, samples of the product, or printed advertising materials that are used for general advertising as well as sales promotion.

(iii) *Location of sales promotion.* The location of sales promotion activity is the place where the trade show or customer meeting is held.

(iv) *Examples.* The principles of paragraph (a)(2)(i) of this section may be illustrated by the following examples:

Example 1. The related supplier sells various export products described in section 924(a) to its foreign customers. As a commission agent for the related supplier with respect to such sales, the FSC performs sales promotion. It contracts with the related supplier to serve as its agent for such purposes. To stimulate the sale of its export products, the related supplier conducts semi-annual meetings with the purchasing agents of its customers at its Kansas City headquarters. Ten or more purchasing agents are reasonably expected to attend each meeting. At such meetings, the purchasing agents see the related supplier's manufacturing facilities, visit with its executives, attend technical updates, and see new export products. These semi-annual customer meetings constitute sales promotion within the meaning of paragraph (a)(2)(i) of this section. Direct costs incurred with respect to the customer meetings are U.S. direct costs because the sales promotion activities occur within the United States.

Example 2. Assume the same facts as in *Example 1*, except that the related supplier exhibits products that only operate on 220 volts at a trade show in the United States. According to the trade show sponsors, the purpose of the show is to increase sales abroad of United States-manufactured products. Since the products exhibited are designed for operation in foreign countries and the purpose of the trade show is to boost sales in those countries, the trade show held in the United States is primarily aimed at the export products described in section 924(a) and not at United States customers. Thus, the trade show constitutes sales promotion within the meaning of paragraph (a)(2)(i) of this section and the direct costs incurred in connection with the trade show are treated as United States direct costs.

(b) *Processing of customer orders and arranging for delivery of the export property.* For purposes of section 924(e), the processing of customer orders and the arranging for delivery of the export property are defined in paragraph (b)(1) and paragraph (b)(2), respectively, of this section. For taxable years beginning after February 19, 1987, if the FSC performs the activities of processing of customer orders and arranging for delivery of the export property and elects to group its transactions, it is considered to have performed the activities with respect to all transactions in the grouping elected by the FSC under §1.924(d)–1(e) during the taxable year if it performs the activities of processing of customer orders and arranging for

delivery of the export property with respect to customers generating 20 percent or more of foreign trading gross receipts within the elected grouping.

(1) *Processing of customer orders*—(i) *Processing of customer orders defined.* The processing of customer orders means notification by the FSC to the related supplier of the order and of the requirements for delivery. The related supplier may have independent knowledge of the order and requirements for delivery. If the FSC does not have a related supplier, the processing of customer orders means communication with the customer by any method such as telephone, telegram, or mail to acknowledge receipt of the order and requirements for delivery. Once the related supplier has been notified by the FSC, or the customer has received an acknowledgement from the FSC, of the order and requirements for delivery, subsequent or prior communications with respect to an order (such as changes in quantity or prospective delivery date) are not included in the definition of processing of customer orders.

(ii) *Direct costs of processing customer orders.* Direct costs of processing of customer orders include salaries of clerical personnel and costs of telephone, telegram, mail, or other communication media (including the costs of operating transmission equipment).

(iii) *Location of processing of customer orders.* The location of this activity is the place where the communication is initiated by the FSC.

(iv) *Examples.* The principles of paragraph (b)(1) of this section may be illustrated by the following examples:

Example 1. A domestic related supplier, using a FSC as its commission agent on the sale of export property to foreign customers, receives an order from one of its foreign customers. Information concerning the receipt of such order and its requirements for delivery are transmitted to the FSC. The FSC from its office outside the United States notifies the related supplier of the order and the requirements for delivery by telex. This notification by the FSC to the related supplier constitutes the processing of the customer's order within the meaning of paragraph (b)(1)(i) of this section. In addition, its direct costs of processing the customer's order are foreign direct costs because the communication is initiated by the FSC from outside the United States.

Example 2. A domestic unrelated supplier manufactures a product which it sells to a buy-sell FSC located in Germany for resale to the FSC's German customers. Upon receiving an order from one of its customers, the FSC telephones the customer from its German office to acknowledge receipt of the order and the requirements for delivery. The acknowledgement constitutes the processing of the customer's order within the meaning of paragraph (b)(1)(i) of this section and the direct costs attributable thereto are foreign direct costs.

(2) *Arranging for delivery*—(i) *Arranging for delivery defined.* The arranging for delivery of export property means the taking of necessary steps to have the export property delivered to the customer in accordance with the requirements of the order. Arranging for delivery does not include preparation of shipping documents (*e.g.*, bill of lading) or the property for shipment (*i.e.*, packaging or crating), or shipment of property (*i.e.*, transportation). Arranging for delivery does include communications with a carrier or freight forwarder to provide transportation (as defined in §1.924(e)–1(c)(1), but without regard to when the commission relationship for purposes of transportation begins) for the export property from the FSC or related supplier to the place where the customer takes possession of the property. Arranging for delivery also includes communications with the customer to notify the customer of the time and place of delivery. The carrier or freight forwarder and the customer may already have knowledge of the information communicated. If the FSC has communicated with the carrier or freight forwarder, where applicable, and the customer to notify it of the time and place of delivery, prior or subsequent communications to either about delivery are not included in the definition of arranging for delivery.

(ii) *Direct costs of arranging for delivery.* The direct costs of arranging for delivery include salaries of clerical personnel and costs of telephone, telegraph, mail, and other communications media, but do not include any actual shipping costs.

(iii) *Location of arranging for delivery.* The location of arranging for delivery activity is the place where the activity is initiated by the FSC.

(iv) *Examples.* The principles of paragraph (b)(2)(i) of this section may be illustrated by the following examples:

Example 1. A FSC earns commissions on the sale of export property by its domestic related supplier to foreign customers. The shipment term of all of the related supplier's sales is F.O.B. (Free on Board) its manufacturing plant in Gary, Indiana. Thus, there is no transportation as defined in §1.924(e)–1(c)(1) with respect to its sales. From its shipping department at the plant, the related supplier telephones carriers to arrange for delivery. It also notifies the FSC by mail of the time and place of delivery of the customer's orders. The FSC from its office outside the United States transmits the received information to the customers. Because there is no transportation to be arranged, this communication alone by the FSC to the customers to notify them of the time and place of delivery constitutes arranging for delivery within the meaning of paragraph (b)(2)(i) of this section.

Example 2. Assume the same facts as in *Example 1,* except that the shipment term of all of the related supplier's sales is C.I.F. (Cost, Insurance, Freight) and that the commission relationship for transportation begins after the export property leaves the United States customs territory. The related supplier telephones a trucking firm and an overseas carrier from its plant in Gary, Indiana to ascertain information on transporting its property by truck to the docks, and by overseas carrier from the docks to the place where the customer takes possession. Upon receiving the necessary information, the related supplier electronically transmits to the FSC the shipping information and the time and place of delivery to the customer. In addition, it instructs the FSC to communicate the necessary shipping information to the carriers to ensure shipment and to notify the customer of the time and place of delivery. The FSC does both from its office located outside of the United States. The communications by the FSC to the carriers and the customer constitute arranging for delivery within the meaning of paragraph (b)(2)(i) of this section.

(c) *Transportation*—(1) *Transportation defined.* For purposes of section 924(e), transportation means moving or shipping the export property during the period when the FSC owns or is responsible for the property, or, if the FSC is acting as a commission agent, during the period when the related supplier owns or is responsible for the property but after the commission relationship for purposes of transportation begins (even if the relationship begins after the property leaves the U.S. customs territory). The FSC or related supplier is treated as responsible for the property when it either has title, bears the risk of loss, or insures the property during shipment. Since a commission FSC will not generally have title or bear the risk of loss, it will, nevertheless, satisfy the transportation test if the related supplier has either title, bears the risk of loss, or insures the property during shipment. Examples of methods of shipping which would qualify as transportation include F.O.B. (Free on Board) destination, C.I.F. (Cost, Insurance, Freight), Ex Ship, and Ex Quay, but do not include C. & F. (Cost and Freight) or F.O.B. shipping point.

(2) *Direct costs of transportation.* The direct costs of transportation include the expenses of shipping, such as fees paid to carriers and freight forwarders, costs of freight insurance, and documentation fees. With respect to fungible commodities, direct costs include only those costs incurred after the goods have been identified to a contract. Transportation costs do not include any of the costs of arranging for delivery. The FSC is considered to engage in transportation activity whenever it pays the costs of shipping the export property and the property is shipped during the period when the FSC owns or is responsible for the property as provided in paragraph (c)(1) of this section. If the customer pays the shipping costs directly, the FSC is not considered to engage in transportation activity. If, however, the FSC pays the shipping costs, the ultimate transfer of those costs to the customer will not disqualify the FSC from engaging in transportation for purposes of section 924(e) regardless of whether the costs are included in the sale price of the export property or separately stated.

(3) *Location of transportation.* The location of transportation activity is the area over which the property is transported. Thus, the portion of total direct costs of transportation treated as foreign direct costs is the portion attributable to transportation outside the United States, determined on the basis of the ratio of mileage outside the U.S. customs territory to total mileage. For purposes of determining

mileage outside U.S. customs territory, goods are treated as leaving U.S. customs territory when they have been tendered to an international carrier for shipment to a foreign location, as long as they are not removed from the custody of the carrier before they reach a point outside U.S. customs territory. The same rule for determining mileage outside the U.S. customs territory will apply to freight forwarders if (i) the forwarder has the risk of loss or is an insurer of the goods, and (ii) the property is shipped on a single bill of lading issued to the FSC or its agent as the shipper.

(4) *Examples.* The principles of paragraph (c) of this section may be illustrated by the following examples:

Example 1. A buy-sell FSC sells export property to a customer located in Canada. The contract between the FSC and the customer requires that the property be shipped F.O.B. its Canadian destination. Under this shipment term, the FSC holds title and bears the risk of loss until the property is tendered at its Canadian destination. Thus, it is responsible for the property during shipment. The FSC instructs its related supplier to ship the property from its manufacturing facilities in St. Louis. The related supplier negotiates two contracts, one for domestic transportation and the second for foreign transportation. A domestic trucking firm transports the property to the Canadian border where a Canadian trucking company is used to transport the property to its Canadian destination. The documentation fees and the fees for the two trucking firms are paid by the FSC. Because the FSC paid the costs of shipping and the property was shipped during the period when the FSC was responsible for the property, the FSC has engaged in transportation activity, the direct costs of which are the fees paid by the FSC. If 70 percent of the mileage from St. Louis to the Canadian destination is associated with the transportation from the Canadian border to the Canadian destination, 70 percent of the FSC's direct transportation costs are foreign direct costs. If, instead of using two trucking firms, the FSC had tendered the goods to a freight forwarder for shipment to a foreign location and the freight forwarder assumed the risk of loss for the goods and issued a single bill of lading, all of the fees paid by the FSC to the freight forwarder would be foreign direct costs.

Example 2. A related supplier sells export property to its foreign customer in Liverpool, England. The contract between the related supplier and the customer requires that the property be shipped C.I.F. Liverpool. The related supplier engages the FSC as its commission agent with respect to its sales to the customer, requiring the FSC to provide transportation to the customer. The FSC contracts with the related supplier to provide the transportation on behalf of the FSC. The commission agreement between the related supplier and the FSC provides that the FSC's responsibilities with respect to transportation of the export property begins after the property leaves the U.S. customs territory. The related supplier hires a domestic trucking firm to transport the shipment to a New York City port where it is loaded on a cargo ship destined for Liverpool at a total cost of $3,000X, $2,750X of which is allocable to mileage from the U.S. customs territory to Liverpool, England. Because the related supplier insures the property during shipment under C.I.F., the property is shipped during the period when the related supplier is treated as responsible for the property. Thus, the FSC, as the related supplier's commission agent, has satisfied the transportation test. In addition, because the FSC's responsibilities with respect to transportation begins when the property leaves U.S. customs territory, the FSC's payment of $2,750X is a foreign direct cost of transportation. The remaining $250X is not a direct cost of transportation to the FSC because the amount was expended before the commission relationship between the FSC and related supplier began.

Example 3. A FSC earns commissions on sales by the related supplier of export property, all of which falls within a single two-digit SIC group. The related supplier is under contract to the FSC to perform on the FSC's behalf all of the section 924(e) activities attributable to the sales. Of all of the sales made during the year, the FSC has no transportation costs with respect to the sales to customer R because the shipment term is F.O.B. the related supplier's Chicago plant. With respect to the sales to customer S, the FSC ships the property F.O.B. its destination and pays 100 percent of the transportation costs, all of which are foreign direct costs because the commission relationship for transportation begins outside the U.S. customs territory. For purposes of determining whether the FSC has satisfied the 85-percent foreign direct cost test for transportation, the FSC groups the sales by product. Because the transportation costs for sales to customer S are 100-percent foreign direct costs and because there are no transportation costs on sales to customer R, the FSC is considered to have met the 85-percent foreign direct cost test for transportation for all the sales in the single two-digit SIC group.

(d) *Determination and transmittal of a final invoice or statement of account and receipt of payment.* For purposes of section 924(e), the determination and

transmittal of a final invoice or statement of account and the receipt of payment are defined as follows.

(1) *Determination and transmittal of a final invoice or statement of account*—(i) *Definitions*—(A) *In general.* The determination and transmittal of a final invoice or statement of account means the assembly of either a final invoice or statement of account and the forwarding of that document to the customer. A FSC may elect to send either final invoices or statements of account and disregard any costs of the alternative not elected. For taxable years beginning after February 19, 1987, a special grouping rule is provided. If the FSC assembles and forwards either a statement of account or a final invoice from outside the United States to customers with sales representing 50 percent of the current year foreign trading gross receipts within a product or product line grouping or to customers with sales representing 50 percent of the prior year foreign trading gross receipts within a product or product line grouping utilized for the current year, all other U.S. costs will be disregarded and the FSC will be deemed to have no U.S. costs with respect to the determination and transmittal of a final invoice or statement of account. 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 apply the 50 percent rule by taking into account the customers and sales of the DISC or interest charge DISC for the preceding taxable year. If no foreign trading gross receipts (or qualified export receipts for DISC purposes) were received in the prior year either by the FSC or by a DISC or interest charge DISC within the controlled group of which the FSC is a member, the FSC must apply the 50 percent rule taking into account customers and foreign trading gross receipts for the current year. In the event that the 50 percent rule is not satisfied, all costs associated with assembly and forwarding of the selected documents (invoices or statements of account) must be included in the costs attributable to activities described in section 924(e)(4).

(B) *Final invoice defined.* A final invoice is an invoice upon which payment is made by the customer. A final invoice must contain the customer's name or identifying number and, with respect to the transaction or transactions, the date, product or service, quantity, price, and amount due. In the alternative, a document will be acceptable as a final invoice even though it does not include all of the above listed information if the FSC establishes that the document is considered to be a final invoice under normal commercial practices. An invoice forwarded to the customer after payment has been tendered or received pursuant to a letter of credit as a receipt for payment satisfies this definition.

(C) *Statement of account defined.* A statement of account is any summary statement forwarded to a customer to inform of, or confirm, the status of transactions occurring within an accounting period during a taxable year that is not less than one month. A statement of account must contain, at a minimum, the customer's name or identifying number, date of the statement of account as of the last day of the accounting period covered by the statement of account and the balance due (even if the balance due is zero). A single final invoice or statement of account can cover more than one transaction with one customer. In the alternative, a document will be accepted as a statement of account even though it does not include all of the above listed information if the FSC establishes that the document is considered a statement of account under normal commercial practice. For these purposes, a document will be considered to be a statement of account under normal commercial practices if it is sent to domestic as well as to export customers in order to inform the customers of the status of transactions during an accounting period. Additional information may be sent separately, such as summary statements forwarded to a related party for purposes of reconciling intercompany accounts for financial reporting requirements. If the information is sent separately, the direct costs associated with the assembly and forwarding of that information are not considered for purposes of section 924(d).

(D) *Assembly and forwarding defined.* Assembly means folding the documents (where applicable), filling envelopes, and addressing envelopes (if window envelopes are not used). Forwarding means mailing or delivery.

(ii) *Direct costs of determination and transmittal of final invoice or statement of account.* Direct costs of this activity include costs of office supplies, office equipment, clerical salaries and costs of mailing or other delivery services, if the costs can be identified or associated directly with the assembly and transmittal of a final invoice or statement of account. Costs of establishing a price, or of communicating prices or other billing information between the FSC and a related supplier are not direct costs of this activity. In addition, the costs of preparing and mailing the final invoices or statements of account to the FSC and the costs of accumulating and formatting data for invoicing or statements of account on computer discs, tapes, or some other storage media along with the costs of transmitting or transporting this data to the FSC are not direct costs of this activity.

(iii) *Location of determination and transmittal of a final invoice or statement of account.* For taxable years beginning before February 19, 1987, the location of this activity is the place where the final invoice or statement of account is assembled for forwarding to the customer or the place from which it is forwarded to the customer. Thus, the forwarding of the final invoice or statement of account from outside the United States is sufficient to source this activity outside the United States. For all other taxable years, the location of this activity is the place where the final invoice or statement of account is both assembled and forwarded to the customer.

(iv) *Examples.* The principles of paragraph (d)(1) of this section may be illustrated by the following examples, all of which apply to taxable years beginning on or after February 19, 1987.

Example 1. A related supplier sells export property to its foreign customers. The related supplier engages the FSC as its commission agent with respect to the sales, requiring the FSC to determine and transmit final invoices or statements of account to the customers with respect to the sales. Annually, the FSC assembles and forwards statements of account to customers representing 40 percent of current year export sales and 35 percent of prior year sales. The statements are sent from its office outside of the United States. The remaining statements of account are sent from the Albany, New York office of the related supplier. The statements are recognized in its industry as a statement of account. Although the statement does not contain all of the information described in §1.924(e)–1(d)(1)(i), it is sent to both domestic and foreign customers of the related supplier to inform the customer of the status of its transactions with the related supplier. The document qualifies as a statement of account under §1.924(e)–1(d)(1)(i); however, the 50 percent test set forth in §1.924(e)–1(d)–1(d)(1)(i)(A) is not satisfied. Therefore, the FSC must take into account all domestic direct costs attributable to assembly and forwarding of statements of account from its domestic office in determining whether the FSC has satisfied the direct costs test with respect to section 924(e)(4) and §924 (e)–1(d).

Example 2. Employees of a FSC, in the FSC's foreign office, fold and place in envelopes the sheet or sheets that constitute the final invoices provided by the related supplier. In addition, the employees address, affix postage to, and mail the envelopes. These activities constitute the determination and transmittal of the final invoices within the meaning of paragraph (d)(1)(i) of this section and, because the final invoices are assembled and forwarded to the customers from outside the United States, all the direct costs of the activities are foreign direct costs.

Example 3. The related supplier sends to the FSC's foreign office a computer tape to be used to prepare a statement of account. A management company, working under contract with the FSC, transcribes the data to a piece of paper which is a statement of account for purposes of §1.924(d)(1)(i), folds the document, and fills, affixes postage to, and mails the envelopes. Only the costs performed by the management company under contract with the FSC that constitute the assembly and forwarding of a statement of account under §1.924(e)–1(d)(1)(i)(D) are direct costs. Therefore, the costs attributable to transcribing the data to a piece of paper are not direct costs for purposes of section 924(e)(4).

(2) *Receipt of payment*—(i) *Receipt of payment defined.* Receipt of payment means the crediting of the FSC's bank account by an amount which is not less than 1.83 percent of the gross receipts (''gross receipts amount'') associated with the transaction. The FSC's bank

account is not credited unless the FSC has the authority to withdraw the amount deposited. Where sales proceeds are factored or where payments from related foreign subsidiaries are netted against amounts owed to these foreign subsidiaries in an intercompany account, crediting of the FSC's bank account with no less than the gross receipts amount of the factoring proceeds or the proceeds, net of offsets, respectively, qualifies as receipt of payment. In addition, where a FSC is precluded from receiving a portion of the proceeds of the export transaction, the FSC may satisfy receipt of payment by receiving no less than the gross receipts amount of the remaining portion of the proceeds in its bank account. In the case of advance or progress payments, each payment constitutes a payment for receipt of payment purposes.

(ii) *Direct costs of receipt of payment.* Direct costs of receiving payment include the expenses of maintaining a bank account of the FSC in which payment is deposited, any fees or service charges incurred for converting the payment into U.S. currency, and any transfer fees incurred with respect to the transfer of funds into and out of the FSC's bank account in accordance with the 35 calendar day rule in paragraph (d)(2)(iii) of this section. The transfer fees and the fees or service charges incurred for currency conversion are considered to be foreign direct costs of receiving payment; however, exchange losses are not costs of receiving payment.

(iii) *Location of receipt of payment.* The location of this activity is the office of the banking institution at which the account is maintained. If payment is made by the purchaser directly to the FSC or the related supplier in the United States, and the FSC or related supplier transfers the gross receipts amount associated with the transaction to a bank account of the FSC outside the United States after receipt of payment (i.e., cash, check, wire transfer, etc.), but no later than 35 calendar days after receipt of good funds (i.e., the clearance of the check) the FSC is considered to have received payment outside the United States. Therefore, all transfer fees and the costs of the foreign bank account are treated as foreign direct costs. The United States bank costs are disregarded. If, however, the related supplier does not transfer the gross receipts amount within 35 calendar days, United States bank costs are not disregarded and are domestic direct costs. In either case, the transfer costs, currency conversion charges, and foreign bank costs remain foreign direct costs. The preceding rules apply both to commission FSCs and buy-sell FSCs.

(iv) *Examples.* The principles of paragraph (d)(2) of this section may be illustrated by the following examples:

Example 1. A FSC earns commissions on sales of export property by its related supplier. The related supplier manufactures and sells its export property to its foreign subsidiaries for resale in their respective countries. From time to time, the foreign subsidiaries will return products to the related supplier for credit and, from time to time, the foreign subsidiaries purchase products in their respective countries and sell such products to the related supplier. These transactions result in various amounts being owed to the foreign subsidiaries. Each month the various inter-company obligations are reviewed. The result of such review of intercompany indebtedness is a netting out of the various intercompany liabilities on the books, to the extent possible, and a flow of funds for the net obligation. Due to the nature of these transactions, the amounts owed by the foreign subsidiaries exceed the amounts which the related supplier owes to the foreign subsidiaries. The gross receipts amount (*i.e.*, 1.83 percent of this net amount) is credited to the FSC's bank account. This constitutes receipt of payment for purposes of paragraph (d)(2)(i) of this section.

Example 2. In a leveraged lease transaction, a FSC-lessor obtains purchase financing from a lending institution. The lending institution retains a security interest in the proceeds and requires that a portion of each rental payment be paid by the lessee directly to the lending institution. Since the FSC is precluded from receiving a portion of the proceeds of the export transaction, the FSC may satisfy the receipt of payment requirement by receiving the gross receipts amount with respect to the remaining proceeds.

Example 3. A buy-sell FSC sells its export property to a foreign customer and is paid by means of a ''draw-down'' letter of credit. Over a substantial period of time prior to delivery of the export property, amounts are advanced to the FSC under the letter of credit. At delivery, the remaining amount available is paid. Each payment made to the FSC

constitutes a payment for receipt of payment purposes and thus the gross receipts amount related to each payment must be credited to the FSC's bank account.

Example 4. An FSC earns commissions on sales of export property by its related supplier. The related supplier regularly collects payments from its foreign customers in a San Francisco bank account and, after the San Francisco bank has collected on the checks, transfers, within 35 calendar days, the gross receipts amounts from its New York bank account to the FSC's bank account located outside the United States. The FSC incurred transfer fees of $160X in addition to a fee of $35X for the maintenance of the FSC's bank account outside the United States during the 35 calendar day period. The maintenance fee relating to the United States bank account for the 35 calendar day period is $45X. The receipt of payment test is met because the gross receipts amounts are transferred after payment but within 35 calendar days to the FSC's bank account located outside the United States. The transfer fees of $160X and the maintenance fee of $35X relating to the FSC's foreign bank account are foreign direct costs. The $45X maintenance fee related to the United States bank account is not a direct cost. If the gross receipts amounts had not been transferred to the FSC's foreign bank account within 35 calendar days, the $45X maintenance fee related to the United States bank account would be considered a United States direct cost. The transfer fee of $160X and the maintenance fee of $35X relating to the FSC's foreign bank account, however, would, nonetheless, be considered as foreign direct costs. The same funds received in San Francisco need not be transferred to the FSC's foreign bank account because money is fungible. For the same reason, the gross receipts amounts need not be transferred from the same bank account in which the payments are received.

(e) *Assumption of credit risk*—(1) *Assumption of credit risk defined.* For purposes of section 924(e), the assumption of credit risk means bearing the economic risk of nonpayment with respect to a transaction. If the FSC is acting as a commission agent for the related supplier, this risk is borne by the FSC if the commission contract transfers the costs of the economic risk of nonpayment with respect to the transaction from the related supplier to the FSC. The FSC may elect on its annual return to bear the economic risk of nonpayment with respect to its transactions during a taxable year by either—

(i) Assuming the risk of a bad debt in accordance with the rules of paragraph (e)(4)(i) of this section,

(ii) Obtaining insurance to cover nonpayment,

(iii) Investigating credit of a customer or a potential customer,

(iv) Factoring trade receivables, or

(v) Selling by means of letters of credit or banker's acceptances.

Only the alternative elected to be performed by the FSC during a taxable year is relevant for purposes of section 924(d). For example, if a buy-sell FSC elects to bear the economic risk of nonpayment with respect to its transaction during a taxable year by assuming the risk of a bad debt in accordance with the rules of paragraph (e)(4)(i) of this section, and also factors the transaction's trade receivables, only the direct costs of assuming the risk of a bad debt are relevant for purposes of section 924(d). For purposes of this paragraph, a potential customer is an unrelated person who is engaged in the purchase or sale of export property on whom an investigation is performed, but with whom no export sales contract is executed.

(2) *Direct costs of assumption of credit risk.* (i) With respect to assuming the risk of a bad debt, the direct costs of the assumption of credit risk in the case of a buy-sell FSC include debts that become uncollectible and charges taken into account in determining additions to bad debt reserves of the FSC. In the case of a commission FSC, the direct costs of the assumption of credit risk include the assumption of the debts and charges of the related supplier attributable to export sales that are allowed as deductions under section 166.

(ii) With respect to insurance, the direct costs of the assumption of credit risk are the costs of obtaining insurance against the risk of nonpayment. Qualifying insurance must be obtained from an unrelated insurer and must cover the risk of nonpayment due to default and bankruptcy by the purchaser. Insurance obtained from a related insurer, or insurance that covers default and bankruptcy due to risks of war or political unrest without covering ordinary default or bankruptcy is not sufficient.

(iii) With respect to investigating credit, the direct costs of assumption of credit risk are the external costs of investigating credit for customers or potential customers, including costs of membership in a credit agency or association for that purpose (but not the costs of approving credit by an internal credit agency).

(iv) With respect to factoring trade receivables, the direct costs of assumption of credit risk are the costs of factoring trade receivables of related and unrelated customers (*e.g.* the amount of the discount and the fees relating to factoring).

(v) With respect to letters of credit or banker's acceptances, the direct costs of assumption of credit risk are the costs of letters of credit or banker's acceptances and the documentary collection costs.

(3) *Location of assumption of credit risk.* The location of the activity of assumption of credit risk is the location of the customer or obligor whose payment is at risk, except that the location of investigating credit is the location of the credit agency or association performing the investigation. A foreign branch of a United States corporation and a foreign office of the United States government are not foreign obligors for purposes of this test. A foreign branch of a United States credit investigation agency or association, however, is treated as located outside the United States.

(4) *Special rules*—(i) *Assuming the risk of a bad debt*—(A) *In general.* If a FSC chooses to bear the economic risk of nonpayment by assuming the risk of a bad debt with respect to a transaction or grouping of transactions and an actual bad debt loss on a foreign trading gross receipt is not incurred in any three consecutive years, the FSC will be deemed to have performed this activity during the first two years of the three year period. For the third year, the FSC will not be deemed to have performed this activity and must satisfy the 85 percent foreign direct costs test by satisfying any two paragraphs included within section 924(e) other than assumption of credit risk activity under section 924(e)(5). An actual bad debt loss will only satisfy the activity test with respect to a single three consecutive year period.

(B) *Example.* The principles of this paragraph may be illustrated by the following example:

Example. In year 1, a related supplier of a commission FSC incurs a bad debt with respect to foreign trading gross receipts owed by a foreign obligor. This expense is the only bad debt incurred with respect to foreign trading gross receipts in year 1. Therefore, the direct costs for the bearing of the economic risk of nonpayment for year 1 are all foreign direct costs and the 85-percent test is satisfied. In year 2, the FSC incurs a bad debt with respect to a U.S. broker/consolidator. The direct costs for year 2 are U.S. direct costs and, therefore, the 85-percent test is not satisfied. No bad debt is incurred in year 3. Because a bad debt with respect to a foreign obligor is incurred in year 1, the FSC is deemed to have satisfied the economic risk of nonpayment for each of years 1, 2 and 3.

(ii) *Grouping with respect to other risk activities.* For taxable years beginning after February 19, 1987, if a FSC elects to bear the economic risk of nonpayment by performing one of the activities described in paragraph (e) of this section and elects to group transactions, it is considered to have performed the elected activity with respect to all transactions within the group during the taxable year if it performs the activity in accordance with the following rules. If a FSC elects to factor trade receivables, at least 20 percent of the face amount of a group's receivables must be factored. If a FSC elects to sell by means of letters of credit or banker's acceptances, a fee must be incurred with respect to 20 percent of the foreign trading gross receipts attributable to sales within the group. If the FSC elects to obtain insurance to cover nonpayment, 20 percent of the face amount of receivables attributable to sales included in the §1.924(d)–1(e) grouping elected by the FSC must be insured. If a FSC elects to investigate credit of customers or potential customers, 20 percent of new or potential customers for which a credit investigation is performed must be investigated.

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