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(1) The subpart F income of the controlled foreign corporation and, if any part of such income is excluded from the income of the United States shareholder under section 963 or section 970(a), the application of such exclusion,

(2) The previously excluded subpart F income of such corporation withdrawn from investment in less developed countries,

(3) The previously excluded subpart F income of such corporation withdrawn from investment in foreign base company shipping operations,

(4) The previously excluded export trade income of such corporation withdrawn from investment, and

(5) The increase in earnings invested by such corporation in United States property.

(c) *Special rules.* Verification of the subpart F income of the controlled foreign corporation for the taxable year shall not be required if—

(1) It can be demonstrated to the satisfaction of the district director that—

(i) The locus and nature of such corporation's activities were such as to make it unlikely that the foreign base company income of such corporation (determined in accordance with paragraph (c)(3) of §1.952–3) exceeded 5 percent of its gross income (determined in accordance with paragraph (b)(1) of §1.952–3) for the taxable year. (For taxable years to which §1.952–3 does not apply, such amounts shall be determined under 26 CFR §1.954–1(d)(3)(i) and (ii) (Revised as of April 1, 1975))), and

(ii) If such corporation reinsures or issues insurance or annuity contracts in connection with United States risks, the 5-percent minimum premium requirement prescribed in paragraph (b) of §1.953–1 has not been exceeded for the taxable year, or

(2) The United States shareholder's pro rata share of such subpart F income is excluded in full from his income under section 963 and the books or records verify the application of such exclusion.

[T.D. 6824, 30 FR 6480, May 11, 1965, as amended by T.D. 7893, 48 FR 22510, May 19, 1983]

## §1.964–4 Verification of certain classes of income.

(a) *In general.* The provisions of this section shall apply for purposes of determining when books or records are sufficient for purposes of §1.964–3 to verify the classes of income described in such section.

(b) *Subpart F income.* Books or records sufficient to verify the subpart F income of a controlled foreign corporation must establish for the taxable year—

(1) Its gross income and deductions,

(2) The income derived from the insurance of United States risks (as provided in paragraph (c) of this section),

(3) The foreign base company income (as provided in paragraph (d) of this section), and

(4) In the case of a United States shareholder claiming the benefit of the exclusion provided in section 952(b) or the limitation provided in section 952(c)—

(i) The items of income excluded from subpart F income by paragraph (b) of §1.952–1 as income derived from sources within the United States, the United States income tax incurred with respect thereto, and the deductions properly allocable thereto and connected therewith, and

(ii) The earnings and profits, or deficit in earnings and profits, of any foreign corporation necessary for the determinations provided in paragraphs (c) and (d) of §1.952–1.

(c) *Income from insurance of United States risks.* Books or records sufficient to verify the income of a controlled foreign corporation from the insurance of United States risks must establish for the taxable year—

(1) That the 5-percent minimum premium requirement prescribed in paragraph (b) of §1.953–1 has not been exceeded, or

(2) The taxable income, as determined under §1.953–4 or §1.953–5, which is attributable to the reinsuring or the issuing of any insurance or annuity contracts in connection with United States risks, as defined in §1.953–2 or §1.953–3.

(d) *Foreign base company income and exclusions therefrom.* Books or records sufficient to verify the income of a controlled foreign corporation which is

foreign base company income must establish for the taxable year the following items:

(1) *Foreign personal holding company income.* The foreign personal holding company income to which section 954(c) and §1.954–2 apply, for which purpose there must be established the gross income from—

(i) All rents and royalties,

(ii) Rents and royalties received in the active conduct of a trade or business from an unrelated person, as determined under section 954(c)(3)(A) and paragraph (d)(1) of §1.954–2,

(iii) Rents and royalties received from a related person for the use of property in the country of incorporation of the controlled foreign corporation, as determined under section 954(c)(4)(C) and paragraph (e)(3) of §1.954–2,

(iv) All dividends, interest, and except where the controlled foreign corporation is a regular dealer in stock or securities, all gains and losses from the sale or exchange of stock or securities,

(v) Dividends, interest, and gains from the sale or exchange of stock or securities, received in the conduct of a banking, financing, or insurance business from an unrelated person, as determined under section 954(c)(3)(B) and paragraph (d)(2) and (3) of §1.954–2,

(vi) Dividends and interest received from a related corporation organized in the country of incorporation of the controlled foreign corporation, as determined under section 954(c)(4)(A) and paragraph (e)(1) of §1.954–2,

(vii) Interest received in the conduct of a banking or other financing business from a related person, as determined under section 954(c)(4)(B) and paragraph (e)(2) of §1.954–2,

(viii) All annuities,

(ix) All gains from commodities transactions described in section 553(a)(3),

(x) All income from estates and trusts described in section 553(a)(4),

(xi) All income from personal service contracts described in section 553(a)(5), and

(xii) All compensation for the use of corporate property by shareholders described in section 553(a)(6).

(2) *Foreign base company sales income.* The foreign base company sales income to which section 954(d) and §1.954–3 apply, for which purpose there must be established the gross income from—

(i) All sales by the controlled foreign corporation of its personal property and all purchases or sales of personal property by such corporation on behalf of another person,

(ii) Purchases and/or sales of personal property in connection with transactions not involving related persons (as defined in paragraph (e)(2) of §1.954–1),

(iii) Purchases and/or sales of personal property manufactured, produced, etc., in the country of incorporation of the controlled foreign corporation, as determined under paragraph (a)(2) of §1.954–3,

(iv) Purchases and/or sales of personal property for use, etc., in the country of incorporation of the controlled foreign corporation, as determined under paragraph (a)(3) of §1.954–3, and

(v) Sales of personal property manufactured or produced by the controlled foreign corporation, as determined under paragraph (a)(4) of §1.954–3.

Where an item of income falls within more than one of subdivisions (ii) through (v) of this subparagraph, it shall be sufficient to establish that it falls within any one of them. If a branch or similar establishment is treated as a wholly owned subsidiary corporation through the application of section 954(d)(2) and paragraph (b) of §1.954–3, the requirements of this subparagraph shall be satisfied separately for each branch or similar establishment so treated and for the remainder of the controlled foreign corporation.

(3) *Foreign base company services income.* The foreign base company services income to which section 954(e) and §1.954–4 apply, for which purpose there must be established the gross income from—

(i) All services performed by the controlled foreign corporation,

(ii) Services other than those (as determined under paragraph (b) of §1.954–4) performed for, or on behalf of, a related person,

(iii) Services performed in the country of incorporation of the controlled foreign corporation, as determined under paragraph (c) of §1.954–4, and

(iv) Services performed in connection with the sale or exchange of, or with an offer or effort to sell or exchange, personal property manufactured, produced, etc., by the controlled foreign corporation, as determined under paragraph (d) of §1.954–4.

Where an item of income falls within more than one of subdivisions (ii) through (iv) of this subparagraph, it shall be sufficient to establish that it falls within any one of them.

(4) *Foreign base company oil related income.* (i) The foreign base company oil related income described in section 954(g) and §1.954–8, for which purpose there must be established, with respect to each foreign country, the gross income derived from—

(A) The processing of minerals extracted (by the taxpayer or by any other person) from oil or gas wells into their primary products, as determined under section 907(c)(2)(A),

(B) The transportation of such minerals or primary products, as determined under section 907(c)(2)(B),

(C) The distribution or sale of such minerals or primary products, as determined under section 907(c)(2)(C),

(D) The disposition of assets used by the taxpayer in a trade or business described in subdivision (A), (B) or (C), as determined under section 907(c)(2)(D),

(E) Dividends, interests, partnership distributions, and other amounts, as determined under section 907(c)(3).

Where an item of income falls within more than one of the listings in paragraphs (d)(4)(i)(A) through (E) of this section, it shall be sufficient to establish that it falls within any one of them.

(ii) If any of the items of income listed in paragraph (d)(4)(i) of this section arising from sources within a foreign country relates to oil, gas, or a primary product thereof and is described in section 954(g)(1)(A) or (B) and §1.954–8(a)(1)(i) or (ii) (and, hence, is not foreign base company oil related income), then there must be established facts sufficient to verify the amount of such item of income which is not foreign base company oil related income. In this regard, the total quantities of oil, gas and primary products thereof which gave rise to such item of income and the portions of such quantities which were extracted or sold within the foreign country must be established.

(5) *Qualified investments in less developed countries.* For rules in effect for taxable years of foreign corporations beginning before January 1, 1976, see 26 CFR 1.964–4(d)(4) (Revised as of April 1, 1975).

(6) *Income derived from aircraft or ships.* For rules in effect for taxable years of foreign corporations beginning before January 1, 1976, see CFR §1.964–4(d)(5) (Revised as of April 1, 1975).

(7) *Foreign base company shipping income.* The foreign base company shipping income to which section 954(f) and §1.954–6 apply, for which purpose there must be established—

(i) Gross income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, as determined under §1.954–6(c),

(ii) Gross income derived from, or in connection with, the performance of services directly related to the use of any aircraft or vessel in foreign commerce, as determined under §1.954–6(d),

(iii) Gross income incidental to income described in subdivisions (i) and (ii) of this subparagraph, as determined under §1.954–6(e),

(iv) Gross income derived from the sale, exchange, or other disposition of any aircraft or vessel used (by the seller or by a person related to the seller) in foreign commerce,

(v) Dividends, interest, and gains described in §§1.954–6(f) and 1.954(b)(1)(viii),

(vi) Income described in §1.954–6(g) (relating to partnerships, trusts, etc.), and

(vii) Exchange gain, to the extent allocable to foreign base company shipping income, as determined under §1.952–2(c)(2)(v)(*b*).

If the controlled foreign corporation has income derived from or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, or derived from, or in connection with, the performance of services directly related to the use of any aircraft or vessel in foreign commerce, it shall be necessary to establish, from the books and records of the

controlled foreign corporation, that such aircraft or vessel was used in foreign commerce within the meaning of subparagraphs (3) and (4) of §1.954–6(b).

(8) *Income on which taxes are not substantially reduced.* The gross income excluded from foreign base company income under section 954(b)(4) and paragraph (b)(3) or (4) of §1.954–1 in the case of a controlled foreign corporation not availed of to substantially reduce income taxes, the income or similar taxes incurred with respect thereto, and all other factors necessary to verify the application of such exclusion.

(9) *Qualified investments in foreign base company shipping operations.* The foreign base company shipping income that is excluded from foreign base company income under section 954(b)(2) and §1.954–1(b)(1).

(10) *Special rule for shipping income.* The distributions received through a chain of ownership described in section 958(a) which are excluded from foreign base company income under section 954(b)(6)(B) and §1.954–1(b)(2).

(11) *Deductions.* The deductions allocable, under paragraph (c) of §1.954–1, to each of the classes and subclasses of gross income described in subparagraphs (1) through (9) of this paragraph.

(e) *Exclusion under section 963.* Books or records sufficient to verify the application of the exclusion provided by section 963 with respect to the subpart F income for the taxable year of a controlled foreign corporation must establish that the conditions set forth in paragraph (a)(2) of §1.963–1 have been met.

(f) *Exclusion under section 970(a).* Books or records sufficient to verify the application for the taxable year of the exclusion provided by section 970(a) in respect of export trade income which is foreign base company income must establish for such year—

(1) That the controlled foreign corporation is an export trade corporation, as defined in section 971(a) and paragraph (a) of §1.971–1,

(2) The export trade income, as determined under section 971(b) and paragraph (b) of §1.971–1, which constitutes foreign base company income,

(3) The export promotion expenses, as determined under section 971(d) and paragraph (d) of §1.971–1, which are allocable to the excludable export trade income,

(4) The gross receipts, and the gross amount on which is computed compensation included in gross receipts, from property in respect of which the excludable export trade income is derived, as described in section 970(a)(1)(B) and paragraph (b)(2)(ii) of §1.970–1, and

(5) The increase in investments in export trade assets, as determined under section 970(c)(2) and paragraph (d)(2) of §1.970–1.

(g–1) *Withdrawal of previously excluded subpart F income from qualified investment in less developed countries.* Books or records sufficient to verify the previously excluded subpart F income of the controlled foreign corporation withdrawn from investment in less developed countries for the taxable year must establish—

(1) The sum of the amounts of income excluded from foreign base company income under section 954(b)(1) and paragraph (b)(1) of §1.954–1 (as in effect for taxable years beginning before January 1, 1976; see 26 CFR 1.954–1(b)(1) (Revised as of April 1, 1975)) for all prior taxable years,

(2) The sum of the amounts of previously excluded subpart F income withdrawn from investment in less developed countries for all prior taxable years, as determined under section 955(a) (as in effect before the enactment of the Tax Reduction Act of 1975) and paragraph (b) of §1.955–1, and

(3) The amount withdrawn from investment in less developed countries for the taxable year as determined under section 955(a) (as in effect before the enactment of the Tax Reduction Act of 1975) and paragraph (b) of §1.955–1.

(g–2) *Withdrawal of previously excluded subpart F income from investment in foreign base company shipping operations.* Books or records sufficient to verify the previously excluded subpart F income of the controlled foreign corporation withdrawn from investment in foreign base company shipping operations for the taxable year must establish—

(1) The sum of the amounts of income excluded from foreign base company income under section 954(b)(2) and paragraph (b)(1) of §1.954–1 for all prior taxable years,

(2) The sum of the amounts of previously excluded subpart F income withdrawn from investment in foreign base company shipping operations for all prior taxable years, as determined under section 955(a) and paragraph (b) of §1.955A–1,

(3) The amount withdrawn from investment in foreign base company shipping operations for the taxable year as determined under section 955(a) and paragraph (b) of §1.955A–1, and

(4) If the carryover (as described in §1.955A–1(b)(3)) of amounts relating to investments in less developed country shipping companies (as described in §1.995–5(b)) is applicable, (i) the amount of the corporation's qualified investments (determined under §1.955–2 other than paragraph (b)(5) thereof) in less developed country shipping companies at the close of the last taxable year of the corporation beginning before January 1, 1976, and (ii) the amount of the limitation with respect to previously excluded subpart F income (determined under §1.955–1(b)(1)(i)(*b*)) for the first taxable year of the corporation beginning after December 31, 1975.

(h) *Withdrawal of previously excluded export trade income from investment.* Books or records sufficient to verify the previously excluded export trade income of the controlled foreign corporation withdrawn from investment for the taxable year must establish the United States shareholder's proportionate share of—

(1) The sum of the amounts by which the subpart F income of such corporation was reduced for all prior taxable years under section 970(a) and paragraph (b) of §1.970–1,

(2) The sum of the amounts described in section 970(b)(1)(B),

(3) The sum of the amounts of previously excluded export trade income of such corporation withdrawn from investment under section 970(b) and paragraph (c) of §1.970–1 for all prior taxable years, and

(4) The amount withdrawn from investment under section 970(b) and paragraph (c) of §1.970–1 for the taxable year.

(i) *Increase in earnings invested in United States property.* Books or records sufficient to verify the increase for the taxable year in earnings invested by the controlled foreign corporations in United States property must establish—

(1) The amount of such corporation's earnings invested in United States property (as defined in section 956(b)(1) and paragraph (a) of §1.956–2) at the close of the current and preceding taxable years, as determined under paragraph (b) of §1.956–1,

(2) The amount of excluded property described in section 956(b)(2) and paragraph (b) of §1.956–2 held by such corporation at the close of such years,

(3) The earnings and profits, to which section 959(c)(1) and paragraph (b)(1) of §1.959–3 apply, distributed by such corporation during the preceding taxable year, and

(4) The amount of increase in earnings invested by such corporation in United States property which is excluded from the United States shareholder's gross income for the taxable year under section 959(a)(2) and paragraph (c) of §1.959–1.

[T.D. 6824, 30 FR 6481, May 11, 1965, as amended by T.D. 7211, 37 FR 21436, Oct. 11, 1972; T.D. 7893, 48 FR 22511, May 19, 1983; T.D. 8331, 56 FR 2849, Jan. 25, 1991]

### §1.964–5 Effective date of subpart F.

Sections 951 through 964 and §§1.951 through 1.964–4 shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such corporations end.

[T.D. 7120, 36 FR 10862, June 4, 1971]

EXPORT TRADE CORPORATIONS

### §1.970–1 Export trade corporations.

(a) *In general.* Sections 970 through 972 provide in general that if a controlled foreign corporation is an export trade corporation for any taxable year, the subpart F income of such corporation shall, subject to limitations provided by section 970(a) and paragraph (b) of this section, be reduced by so