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contingent component. Any amount received in nonfunctional currency from a component consisting of a contingent payment shall be translated into functional currency at the spot rate on the date of receipt. Except in the case when the payment becomes fixed more than six months before the payment is due, no foreign currency gain or loss shall be recognized on a contingent payment component.

(ii) *Certain delayed contingent payments*—(A) *Separate debt instrument relating to the fixed component.* The rules of §1.1275–4(c)(4)(iii) shall apply to a contingent component the payment of which becomes fixed more than 6 months before the payment is due. For this purpose, the denomination currency of the separate debt instrument relating to the fixed payment shall be the currency in which payment is to be made and the test rate for such separate debt instrument shall be determined in the currency of that instrument. If the separate debt instrument relating to the fixed payment is denominated in nonfunctional currency, the rules of §1.988–2(b)(2) shall apply to that instrument for the period beginning on the date the payment is fixed and ending on the payment date.

(B) *Contingent component.* With respect to the contingent component, the issue price considered to have been paid by the issuer to the holder under §1.1275–4(c)(4)(iii)(A) shall be translated, if necessary, into the functional currency of the issuer or holder at the spot rate on the date the payment becomes fixed.

(5) *Basis different from adjusted issue price.* The rules of §1.1275–4(c)(5) shall apply to an instrument subject to this paragraph (e).

(6) *Treatment of a holder on sale, exchange, or retirement.* The rules of §1.1275–4(c)(6) shall apply to an instrument subject to this paragraph (e).

(f) *Rules for nonfunctional currency tax exempt obligations described in §1.1275–4(d)*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, section 1.988–6 shall not apply to a debt instrument the interest on which is excluded from gross income under section 103(a).

(2) *Operative rules.* [Reserved]

(g) *Effective date.* This section shall apply to debt instruments issued on or after October 29, 2004.

[T.D. 9157, 69 FR 52819, Aug. 30, 2004]

§1.989(a)–1 Definition of a qualified business unit.

(a) *Applicability*—(1) *In general.* This section provides rules relating to the definition of the term ''qualified business unit'' (QBU) within the meaning of section 989.

(2) *Effective date.* These rules shall apply to taxable years beginning after December 31, 1986. However, any person may apply on a consistent basis §1.989(a)–1T (c) of the Temporary Income Tax Regulations in lieu of §1.989(a)–1 (c) to all taxable years beginning after December 31, 1986, and on or before February 5, 1990. For the text of the temporary regulation, see 53 FR 20612 (June 8, 1988).

(b) *Definition of a qualified business unit*—(1) *In general.* A QBU is any separate and clearly identified unit of a trade or business of a taxpayer provided that separate books and records are maintained.

(2) *Application of the QBU definition*—(i) *Persons*—(A) *Corporations.* A corporation is a QBU.

(B) *Individuals.* An individual is not a QBU.

(C) *Partnerships.* A partnership, other than a section 987 aggregate partnership as defined in §1.987–1(b)(5), is a QBU.

(D) *Trusts and estates.* A trust or estate is a QBU of a beneficiary.

(ii) *Activities.* Activities of a corporation, partnership, trust, estate, or individual qualify as a QBU if—

(A) The activities constitute a trade or business; and

(B) A separate set of books and records is maintained with respect to the activities.

(3) *Special rule.* Any activity (wherever conducted and regardless of its frequency) that produces income or loss that is, or is treated as, effectively connected with the conduct of a trade or business within the United States shall be treated as a separate QBU, provided the books and records requirement of paragraph (d)(2) of this section is satisfied.

(4) *Effective/applicability date.* Generally, the revisions to paragraph (b)(2)(i) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to §1.987–11(b) a taxpayer applies §§1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in §1.987–11(a), then the effective date of the revisions to paragraph (b)(2)(i) of this section with respect to the taxpayer shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

(c) *Trade or business.* The determination as to whether activities constitute a trade or business is ultimately dependent upon an examination of all the facts and circumstances. Generally, a trade or business for purposes of section 989(a) is a specific unified group of activities that constitutes (or could constitute) an independent economic enterprise carried on for profit, the expenses related to which are deductible under section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes). To constitute a trade or business, a group of activities must ordinarily include every operation which forms a part of, or a step in, a process by which an enterprise may earn income or profit. Such group of activities must ordinarily include the collection of income and the payment of expenses. It is not necessary that the activities carried out by a QBU constitute a different trade or business from those carried out by other QBUs of the taxpayer. A vertical, functional, or geographic division of the same trade or business may be a trade or business for this purpose provided that the activities otherwise qualify as trade or business under this paragraph (c). However, activities that are merely ancillary to a trade or business will not constitute a trade or business under this paragraph (c). Activities of an individual as an employee are not considered by themselves to constitute a trade or business under this paragraph (c).

(d) *Separate books and records*—(1) *General rule.* Except as provided in paragraph (d)(2) of this section, a separate set of books and records shall include books of original entry and ledger accounts, both general and subsidiary, or similar records. For example, in the case of a taxpayer using the cash receipts and disbursements method of accounting, the books of original entry include a cash receipts and disbursements journal where each receipt and each disbursement is recorded. Similarly, in the case of a taxpayer using an accrual method of accounting, the books of original entry include a journal to record sales (accounts receivable) and a journal to record expenses incurred (accounts payable). In general, a journal represents a chronological account of all transactions entered into by an entity for an accounting period. A ledger account, on the other hand, chronicles the impact during an accounting period of the specific transactions recorded in the journal for that period upon the various items shown on the entity's balance sheet (*i.e.,* assets, liabilities, and capital accounts) and income statement (*i.e.,* revenues and expenses).

(2) *Special rule.* For purposes of paragraph (b)(3) of this section, books and records include books and records used to determine income or loss that is, or is treated as, effectively connected with the conduct of a trade or business within the United States.

(3) *Proper reflection on the books of the taxpayer or qualified business unit.* The principles of §1.987–2(b) shall apply in determining whether an asset, liability, or item of income or expense is reflected on the books of a qualified business unit (and therefore is attributable to such unit).

(4) *Effective/applicability date.* Generally, the revisions to paragraph (d)(3) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to §1.987–11(b) a taxpayer applies §§1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in §1.987–11(a), then the revisions to paragraph (b)(2)(i) of this section shall apply with respect to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

(e) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. Corporation X is a domestic corporation. Corporation X manufactures widgets in the U.S. for export. Corporation X sells widgets in the United Kingdom through a branch office in London. The London office has its own employees and solicits and processes orders. Corporation X maintains in the U.S. a separate set of books and records for all transactions conducted by the London office. Corporation X is a QBU under paragraph (b)(2)(i) of this section because of its corporate status. The London branch office is a QBU under paragraph (b)(2)(ii) of this section because (1) the sale of widgets is a trade or business as defined in paragraph (c) of this section; and (2) a complete and separate set of books and records (as described in paragraph (d) of this section) is maintained with respect to its sales operations.

Example 2. A domestic corporation incorporates a wholly-owned subsidiary in Switzerland. The domestic corporation is a manufacturer that markets its product abroad primarily through the Swiss subsidiary. To facilitate sales of the parent's product in Europe, the Swiss subsidiary has branch offices in France and West Germany that are responsible for all marketing operations in those countries. Each branch has its own employees, solicits and processes orders, and maintains a separate set of books and records. The domestic corporation and the Swiss subsidiary are both QBUs under paragraph (b)(2)(i) of this section because of their corporate status. The French and West German branches are QBUs of the Swiss subsidiary. They satisfy paragraph (b)(2)(ii) because each constitutes a trade or business (as defined in paragraph (c) of this section) and because separate sets of books and records (as described in paragraph (d) of this section) of their respective operations is maintained. Each branch is considered to have a trade or business although each is a geographical division of the same trade or business.

Example 3. W is a domestic corporation that manufactures product X in the United States for sale worldwide. All of W's sales functions are conducted exclusively in the United States. W employs individual Q to work in France. Q's sole function is to act as a courier to deliver sales documents to customers in France. With respect to Q's activities in France, a separate set of books and records as described in paragraph (d) is maintained. Under paragraph (c) of this section, Q's activities in France do not constitute a QBU since they are merely ancillary to W's manufacturing and selling business. Q is not considered to have a QBU because an individual's activities as an employee are not considered to constitute a trade or business of the individual under paragraph (c).

Example 4. The facts are the same as in example (3) except that the courier function is the sole activity of a wholly-owned French subsidiary of W. Under paragraph (b)(2)(i) of this section, the French subsidiary is considered to be a QBU.

Example 5. A corporation incorporated in the Netherlands is a subsidiary of a domestic corporation and a holding company for the stock of one or more subsidiaries incorporated in other countries. The Dutch corporation's activities are limited to paying its directors and its administrative expenses, receiving capital contributions from its United States parent corporation, contributing capital to its subsidiaries, receiving dividend distributions from its subsidiaries, and distributing dividends to its domestic parent corporation. Under paragraph (b)(2)(i) of this section, the Netherlands corporation is considered to be a QBU.

Example 6. Taxpayer A, an individual resident of the United States, is engaged in a trade or business wholly unrelated to any type of investment activity. A also maintains a portfolio of foreign currency-denominated investments through a foreign broker. The broker is responsible for all activities necessary to the management of A's investments and maintains books and records as described in paragraph (d) of this section, with respect to all investment activities of A. A's investment activities qualify as a QBU under paragraph (b)(2)(ii) of this section to the extent the activities engaged in by A generate expenses that are deductible under section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

Example 7. Taxpayer A, an individual resident of the United States, is the sole shareholder of foreign corporation (FC) whose activities are limited to trading in stocks and securities. FC is a QBU under paragraph (b)(2)(i) of this section.

Example 8. Taxpayer A, an individual resident of the United States, markets and sells in Spain and in the United States various products produced by other United States manufacturers. A has an office and employs a salesman to manage A's activities in Spain, maintains a separate set of books and records with respect to his activities in Spain, and is engaged in a trade or business as defined in paragraph (c) of this section. Therefore, under paragraph (b)(2)(ii) of this section, the activities of A in Spain are considered to be a QBU.

Example 9. Foreign corporation FX is incorporated in Mexico and is wholly owned by a domestic corporation. The domestic corporation elects to treat FX as a domestic corporation under section 1504(d). FX operates entirely in Mexico and maintains a separate set of books and records with respect to its

activities in Mexico. FX is a QBU under paragraph (b)(2)(i) of this section. The activities of FX in Mexico also constitute a QBU under paragraph (b)(2)(ii) of this section.

Example 10. F, a foreign corporation, computes a gain of $100 from the disposition of a United States real property interest (as defined in section 897(c)). The gain is taken into account as if F were engaged in a trade or business in the United States and as if such gain were effectively connected with such trade or business. F is a QBU under paragraph (b)(2)(i) of this section because of its corporate status. F's disposition activity constitutes a separate QBU under paragraph (b)(3) of this section.

[T.D. 8279, 55 FR 284, Jan. 4, 1990, as amended by T.D. 9794, 81 FR 88851, Dec. 8, 2016]

§ 1.989(b)–1 Definition of weighted average exchange rate.

For purposes of section 989(b)(3) and (4), the term ''weighted average exchange rate'' means the simple average of the daily exchange rates (determined by reference to a qualified source of exchange rates described in §1.988–1(d)(1)), excluding weekends, holidays and any other nonbusiness days for the taxable year.

[T.D. 8263, 54 FR 38664, Sept. 20, 1989. Redesignated by T.D. 8367, 56 FR 48437, Sept. 25, 1991; 57 FR 6060, Feb. 18, 1992; T.D. 9452, 74 FR 27890, June 11, 2009]

DOMESTIC INTERNATIONAL SALES CORPORATIONS

§ 1.991–1 Taxation of a domestic international sales corporation.

(a) *In general.* A corporation which is a DISC for a taxable year is not subject to any tax imposed by subtitle A of the Code (sections 1 through 1564) for such taxable year, except for the tax imposed by chapter 5 thereof (sections 1491 through 1494) on certain transfers to avoid tax. Thus, for example, a corporation which is a DISC for a taxable year is not subject for such year to the corporate income tax (section 11), the minimum tax on tax preferences (sections 56 through 58), or the accumulated earnings tax (sections 531 through 537). A DISC is liable for the payment of all taxes payable by corporations under other subtitles of the Code, such as, for example, income taxes withheld at the source and other employment taxes under subtitle C and the interest equalization tax and other miscellaneous excise taxes imposed by subtitle D. In addition, a DISC is subject to the provisions of chapter 3 of subtitle A (including section 1461), relating to withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds. See §1.992–1 for the definition of the term ''DISC.''

(b) *Determination of taxable income—*(1) *In general.* Although a DISC is not subject to tax under subtitle A of the Code (other than chapter 5 thereof), a DISC's taxable income shall be determined for each taxable year in order to determine, for example, the amount deemed distributed for that taxable year to its shareholders pursuant to §1.995–2. Except as otherwise provided in the Code and the regulations thereunder, the taxable income of a DISC shall be determined in the same manner as if the DISC were a domestic corporation which had not elected to be treated as a DISC. Thus, for example, a DISC chooses its method of depreciation, inventory method, and annual accounting period in the same manner as if it were a corporation which had not elected to be treated as a DISC. Any elections affecting the determination of taxable income shall be made by the DISC. Thus, as a further example, a DISC which makes an installment sale described in section 453 is able to avail itself of the benefits of section 453: *Provided,* The DISC complies with the election requirements of such section. See §1.995–2(e) and §1.996–8 and the regulations thereunder for rules relating to the application for a taxable year of a DISC of a deduction under section 172 for a net operating loss carryback or carryover or of a capital loss carryback or carryover under section 1212.

(2) *Choice of method of accounting.* A DISC may, generally, choose any method of accounting permissible under section 446(c) and the regulations thereunder. However, if a DISC is a member of a controlled group (as defined in §1.993–1(k)), the DISC may not choose a method of accounting which, when applied to transactions between the DISC and other members of the controlled group, will result in a material distortion of the income of the DISC or any other member of the controlled group. Such a material distortion of income