

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 much of such corporation's export trade income as constitutes foreign base company income. To the extent subpart F income of an export trade corporation is reduced under section 970 and this section, an amount is required by section 970(b) and paragraph (c) of this section to be included in gross income of United States shareholders of the corporation if there is a subsequent decrease in such corporation's investments in export trade assets. See section 971(a) and paragraph (a) of §1.971-1 for definition of the term "export trade corporation", section 971(b) and paragraph (b) of §1.971-1 for definition of the term "export trade income", and section 971(c) and paragraph (c) of §1.971-1 for definition of the term "export trade assets".

(b) *Amount by which export trade income shall reduce subpart F income—(1) Deductible amount.* The subpart F income, determined as provided in section 952 and the regulations thereunder but without regard to section 970 and this paragraph, of a controlled foreign corporation which is an export trade corporation for its taxable year shall be reduced by an amount equal to so much of its export trade income as constitutes foreign base company income for such taxable year, but only to the extent that such amount of export trade income does not exceed the limitation determined under subparagraph (2) of this paragraph for such taxable year. See section 972 and §1.972-1 for rules relating to the consolidation of export trade corporations for purposes of determining the limitations de-

scribed in subparagraph (2) of this paragraph.

(2) *Limitation on the amount of export trade income deductible from subpart F income.* The amount by which subpart F income of an export trade corporation may be reduced for any taxable year under subparagraph (1) of this paragraph may not exceed whichever of the following limitations is the smallest:

(i) The amount which is equal to 150 percent of the export promotion expenses, as defined in section 971(d) and paragraph (d) of §1.971-1, of the export trade corporation paid or incurred during the taxable year which are properly allocable to the receipt or the production of so much of its export trade income as constitutes foreign base company income for such taxable year;

(ii) The amount which is equal to 10 percent of the gross receipts (other than from commissions, fees, or other compensation for services), plus 10 percent of the gross amount upon the basis of which are computed commissions, fees, or other compensation for services included in gross receipts, of the export trade corporation received or accrued during the taxable year from, or in connection with, the sale, installation, operation, maintenance, or use of property in respect of which such corporation derives export trade income which constitutes foreign base company income for such taxable year; or

(iii) The amount which bears the same ratio to the increase in investments in export trade assets, as defined in section 970(c)(2) and paragraph (d)(2) of this section, of the export trade corporation for its taxable year as the export trade income which constitutes foreign base company income of such corporation for such taxable year bears to the entire export trade income of the corporation for such year.

Under subdivision (ii) of this subparagraph, in the case of minimum or maximum fee arrangements, the determination shall be made on the basis of the actual gross amounts with respect to which such fees are paid, rather than on the basis of the amounts upon which such minimum or maximum fees are computed. All determinations of limitations under this subparagraph shall be made on an aggregate basis

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and not with respect to separate items or categories of income described in paragraph (b)(1) of § 1.971-1.

(3) *Determination of export promotion expense limitation.* For purposes of determining the limitation contained in subparagraph (2)(i) of this paragraph for any taxable year of the export trade corporation, there shall be taken into account with respect to those items or categories of export trade income which constitute foreign base company income the entire amount of those export promotion expenses which are directly related to such items or categories of income and a ratable part of any other export promotion expenses which are indirectly related to such items or categories of income, except that no export promotion expense shall be allocated to an item or category of income to which it clearly does not apply and no deduction allowable to such corporation under section 882(c) and the regulations thereunder shall be taken into account.

(4) *Application of section 482.* The limitations provided in section 970(a) and subparagraph (2) of this paragraph shall not affect the authority of the district director to apply the provisions of section 482 and the regulations thereunder, relating to allocation of income and deductions among taxpayers.

(5) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation A is a wholly owned subsidiary of domestic corporation M. Both corporations use the calendar year as the taxable year. For 1963, A Corporation's subpart F income determined under section 952 and the regulations thereunder is \$35, the total of its gross receipts and gross amounts referred to in subparagraph (2)(ii) of this paragraph is \$310, its export promotion expenses properly allocable to its export trade income which constitutes foreign base company income are \$18, its increase in investments in export trade assets is \$32, and its export trade income is \$40, of which \$30 constitutes foreign base company income and \$10 does not constitute foreign base company income. The subpart F income of A Corporation for 1963 as reduced under section 970(a) is \$11, determined as follows:

(i) Subpart F income \$35

(ii) Less: \$30 export trade income which constitutes foreign base company income, but deduction not to exceed the smallest of the following limitations (smallest of (a), (b), or (c)):

(a) 150 percent of allocable export promotion expenses referred to in subparagraph (2)(i) of this paragraph (150% of \$18)	\$27	
(b) 10 percent of gross receipts and gross amounts referred to in subparagraph (2)(ii) of this paragraph (10% of \$310)	\$31	
(c) Amount which bears to the increase in investments in export trade assets (\$32) the same ratio as the export trade income which constitutes foreign base company income (\$30) bears to total export trade income (\$40) (75% [\$30/\$40] of \$32)	\$24	\$24

(iii) Subpart F income as reduced under section 970(a) 11

Example 2. The facts are the same as in example 1, except that A Corporation's export promotion expenses properly allocable to export trade income which constitutes foreign base company income are \$14 instead of \$18. The applicable limitation on the amount deductible from A Corporation's subpart F income for 1963 is \$21 (150% of \$14) instead of \$24. The subpart F income as reduced under section 970(a) is \$14 (\$35 less \$21).

Example 3. The facts are the same as in example 1, except that the total amount of A Corporation's gross receipts and gross amounts referred to in subparagraph (2)(ii) of this paragraph is \$200 instead of \$310. The applicable limitation on the amount deductible from A Corporation's subpart F income for 1963 is \$20 (10 percent of \$200) instead of \$24. The subpart F income as reduced under section 970(a) is \$15 (\$35 less \$20).

Example 4. The facts are the same as in example 1, except that A Corporation derives its export trade income which constitutes foreign base company income of \$30 in a service arrangement with M Corporation under which it receives as a fee 5 percent of the gross receipts from M Corporation's sales or a minimum fee of \$30. Such gross receipts are \$220. The gross amounts taken into account in determining the limitation under subparagraph (2)(ii) of this paragraph are \$220. The applicable limitation on the amount deductible from A Corporation's subpart F income for 1963 is \$22 (10 percent of \$220) instead of \$24. The subpart F income as reduced under section 970(a) is \$13 (\$35 minus \$22).

Example 5. The facts are the same as in example 1, except that A Corporation derives its export trade income which constitutes foreign base company income of \$30 in a service arrangement with M Corporation under which it receives as a fee 9 percent of the gross receipts from M Corporation's sales or a maximum fee of \$30. Such gross receipts are \$400. In such instance, the limitation

under (ii)(b) of example 1 is \$40 (10 percent of \$400) instead of \$31. The applicable limitation on the amount deductible from A Corporation's subpart F income for 1963 is \$24, the smallest of the three limitations. The subpart F income as reduced under section 970(a) is \$11 (\$35 less \$24).

(c) *Withdrawal of previously excluded export trade income*—(1) *Inclusion of withdrawal in income of United States shareholders.* If—

(i) A controlled foreign corporation was an export trade corporation for any taxable year,

(ii) Such corporation in any such taxable year derived subpart F income which, under the provisions of section 970(a) and paragraph (b) of this section, was reduced, and

(iii) Such corporation has in a subsequent taxable year a decrease in investments in export trade assets,

every person who is a United States shareholder, as defined in section 951(b), of such corporation on the last day of such subsequent taxable year on which such corporation is a controlled foreign corporation shall include in his gross income, under section 951(a)(1)(A)(ii) and the regulations thereunder as an amount to which section 955 (as in effect before the enactment of the Tax Reduction Act of 1975) applies, his pro rata share of the amount of such decrease in investments but only to the extent that such pro rata share does not exceed the limitations determined under subparagraph (2) of this paragraph. A United States shareholder's pro rata share of a controlled foreign corporation's decrease for any taxable year in investments in export trade assets shall be his pro rata share of such corporation's decrease for such year determined under section 970(c)(3) and paragraph (d)(3) of this section.

(2) *Limitations applicable in determining amount includible in income*—(i) *General.* A United States shareholder's pro rata share of a controlled foreign corporation's decrease in investments in export trade assets for any taxable year of such corporation shall, for purposes of determining an amount to be included in the gross income for any taxable year of such shareholder, not exceed the lesser of the limitations de-

termined under (a) and (b) of this subdivision:

(a) Such shareholder's pro rata share of the sum of the controlled foreign corporation's earnings and profits (or deficit in earnings and profits) for the taxable year, computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year, plus his pro rata share of the sum of its earnings and profits (or deficits in earnings and profits) accumulated for prior taxable years beginning after December 31, 1962, or

(b)(1) Such shareholder's pro rata share of the sum of the amounts by which the subpart F income of such controlled foreign corporation for prior taxable years was reduced under section 970(a) and paragraph (b) of this section, plus

(2) Such shareholder's pro rata share of the sum of the amounts which were not included in the subpart F income of such controlled foreign corporation for such prior taxable years by reason of the application of section 972 and § 1.972-1, minus

(3) Such shareholder's pro rata share of the sum of the amounts which were previously included in his gross income for prior taxable years under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) and this paragraph with respect to such controlled foreign corporation.

The net amount determined under (b) of this subdivision with respect to any stock owned by the United States shareholder shall be determined without taking into account any amount attributable to a period prior to the date on which such shareholder acquired such stock. See section 1248 and the regulations thereunder for rules governing the treatment of gain from sales or exchanges of stock in certain foreign corporations.

(ii) *Treatment of earnings and profits.* For purposes of determining earnings and profits of a controlled foreign corporation under subdivision (1) (a) of this subparagraph, such earnings and profits shall be considered not to include any amounts which are attributable to—

(a) Amounts which are, or have been, included in the gross income of a

United States shareholder of such controlled foreign corporation under section 951(a) (other than an amount included in the gross income of a United States shareholder under section 951(a)(1)(A)(ii) or section 951(a)(1)(B) for the taxable year) and have not been distributed, or

(b)(1) Amounts which for the current taxable year, are included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) or would be so included under such section but for the fact that such amounts were distributed to such shareholder during the taxable year, or

(2) Amounts which, for any prior taxable year, have been included in the gross income of a United States shareholder of such controlled foreign corporation under section 551(b) and have not been distributed.

The rules of this subdivision apply only in determining the limitation on a United States shareholder's pro rata share of a controlled foreign corporation's decrease in investments in export trade assets. See section 959 and the regulations thereunder for limitations on the exclusion of previously taxed earnings and profits.

(iii) *Rules of application.* The determinations made under subdivision (i) of this subparagraph for purposes of determining the United States shareholder's pro rata share of a controlled foreign corporation's decrease in investments in export trade assets for any taxable year shall be made on the basis of the stock such shareholder owns, within the meaning of section 958(a) and the regulations thereunder, in the controlled foreign corporation on the last day in the taxable year on which such corporation is a controlled foreign corporation even though such shareholder owned more or less stock in such corporation prior to that date. See section 972 and paragraph (b)(3) of § 1.972-1 for rules relating to the allocation of a decrease in investments in export trade assets of export trade corporations in a consolidated chain of such corporations. See section 951(a)(3) and the regulations thereunder for an additional limitation upon the amount of a United States shareholder's pro

rata share determined under this paragraph.

(3) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation A, which has one class of stock outstanding, is a wholly owned subsidiary of domestic corporation M throughout 1963 and 1964. Both corporations use the calendar year as the taxable year. For 1963, A Corporation qualifies as an export trade corporation and its subpart F income, determined in accordance with the provisions of section 952 and the regulations thereunder, is reduced by \$20 under the provisions of section 970(a) and paragraph (b) of this section. Section 972 is assumed not to apply to A Corporation. For 1964, A Corporation has a decrease of \$8 in investments in export trade assets. For 1963 and 1964, A Corporation has earnings and profits of \$30 (determined under the provisions of subparagraph (2) of this paragraph). Corporation M's pro rata share of A Corporation's decrease in investments in export trade assets for 1964 which is includible in M Corporation's gross income for 1964 under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) is \$8, determined as follows:

(i) Corporation M's pro rata share of A Corporation's decrease in investments in export trade assets for 1964 (100% of \$8)			\$8
(ii) Limitation on amount includible in gross income of M Corporation for 1964 (smaller of (a) or (b)):			
(a) Corporation M's pro rata share of A Corporation's earnings and profits for 1963 and 1964 determined under subparagraph (2) of this paragraph (100% of \$30)		\$30	
(b) Corporation M's pro rata share of amounts by which the subpart F income of A Corporation for 1963 was reduced under section 970(a) (100% of \$20)		\$20	
Plus: Corporation M's pro rata share of amounts which were not included in subpart F income of A Corporation for 1963 by reason of the application of section 972		0	
Total		20	
Less: Corporation M's pro rata share of the sum of amounts which were previously included in gross income of M Corporation under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) with respect to A Corporation		0	20
(iii) Corporation M's pro rata share includible in gross income for 1964 under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) (smaller of (i) or (ii))			8

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Example 2. Assume the same facts as in example 1, except that on February 14, 1965, M Corporation sells 25 percent of its stock in A Corporation to N Corporation. Corporation N is a domestic corporation which also uses the calendar year as a taxable year. For 1965, A Corporation has a decrease of \$16 in investments in export trade assets. Corporation A's earnings and profits for 1963 and 1964 (determined under the provisions of subparagraph (2) of this paragraph) are \$22 (\$30 minus \$8). Corporation A's earnings and profits for 1965 are \$6 (determined under the provisions of subparagraph (2) of this paragraph). For 1965, M Corporation's pro rata share of A Corporation's decrease in investments in export trade assets which is includible in M Corporation's gross income under section 951(a)(1)(A)(ii) is \$9, and N Corporation's pro rata share includible in gross income under such section is \$0, determined as follows:

M CORPORATION		
(i) Corporation M's pro rata share of A Corporation's decrease in investments in export trade assets for 1965 (75% of \$16)	\$12	
(ii) Limitation on amount includible in gross income of M Corporation for 1965 (smaller of (a) or (b)):		
(a) Corporation M's pro rata share of A Corporation's earnings and profits for 1963, 1964, and 1965 determined under subparagraph (2) of this paragraph (75% of \$28)	\$21	
(b) Corporation M's pro rata share of amounts by which the subpart F income of A Corporation for 1963 was reduced under section 970(a) (75% of \$20)	\$15	
Plus: Corporation M's pro rata share of amounts which were not included in subpart F income of A Corporation for 1963 and 1964 by reason of the application of section 972	0	
Total	\$15	
Less: Corporation M's pro rata share of the sum of amounts which were previously included in gross income of M Corporation under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) with respect to A Corporation (75% of \$8)	6	9
(iii) Corporation M's pro rata share includible in gross income for 1965 under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) (smaller of (i) or (ii))		9
N CORPORATION		
(i) Corporation N's pro rata share of A Corporation's decrease in investments in export trade assets for 1965 (25% of \$16)		0

M CORPORATION—Continued		
(ii) Limitation on amount includible in gross income of N Corporation for 1965 (smaller of (a) or (b)):		
(a) Corporation N's pro rata share of A Corporation's earnings and profits for 1963, 1964, and 1965 determined under subparagraph (2) of this paragraph (25% of \$28)	07	
(b) Corporation N's pro rata share of amounts by which the subpart F income of A Corporation for 1963 was reduced under section 970(a) (amounts prior to 2/14/65 not being taken into account)	0	
Plus: Corporation N's pro rata share of amounts which were not included in subpart F income of A Corporation for 1963 and 1964 by reason of the application of section 972 (amounts prior to 2/14/65 not being taken into account)	0	
Total	0	
Less: Corporation N's pro rata share of the sum of amounts which were previously included in gross income of N Corporation under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) with respect to A Corporation (amounts prior to 2/14/65 not being taken into account)	0	0
(iii) Corporation N's pro rata share includible in gross income for 1965 under section 951(a)(1)(A)(ii) by reason of the application of section 970(b) (smaller of (i) or (ii))		0

(d) *Investments in export trade assets—*
 (1) *Amount of investments.* For purposes of sections 970 through 972 and §§1.970-1 to 1.972-1, inclusive, export trade assets shall be taken into account on the following bases:

(i) *Working capital.* Working capital to which section 971(c)(1) applies shall be taken into account at the adjusted basis of current assets, determined as of the applicable determination date, less any current liabilities (except as provided in subdivision (iii) of this subparagraph).

(ii) *Other export trade assets.* Inventory to which section 971(c)(2) applies, facilities to which section 971(c)(3) applies, and evidences of indebtedness to which section 971(c)(4) applies, shall be taken into account at their adjusted bases as of the applicable determination date, reduced by any liabilities (except as provided in subdivision (iii) of this subparagraph) to which such property is subject on such date. To be taken into account under this subparagraph, a liability must constitute a

specific charge against the property involved. Thus, a liability evidenced by an open account or a liability secured only by the general credit of the controlled foreign corporation will not be taken into account. On the other hand, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item on the applicable determination date bears to the adjusted basis of all such items on such date. A liability in excess of the adjusted basis of the property which is subject to such liability will not be taken into account for the purpose of reducing the adjusted basis of other property which is not subject to such liability. See paragraph (c)(6) of § 1.971-1 for treatment of export trade assets which constitute working capital to which section 971(c)(1) applies and which also constitute inventory to which section 971(c)(2) applies or evidences of indebtedness to which section 971(c)(4) applies.

(iii) *Treatment of certain liabilities.* For purposes of subdivisions (i) and (ii) of this subparagraph, a current liability, or a specific charge created with respect to any item of property, principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation's investments in export trade assets shall be taken into account in such a manner as to properly reflect the controlled foreign corporation's investments in export trade assets; whether a specific charge or current liability is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to a loan is whether the loan is from a related person, as defined in section 954(d)(3) and paragraph (e) of § 1.954-1.

(iv) *Statement required.* If for purposes of this section a United States shareholder of a controlled foreign corporation reduces the adjusted basis of property which constitutes an export trade asset on the ground that such property is subject to a liability, he shall attach to his return a statement setting forth

the adjusted basis of the property before the reduction and the amount and nature of the reduction.

(2) *Increase in investments in export trade assets.* For purposes of section 970(a) and paragraph (b) of this section, the amount of increase in investments in export trade assets of a controlled foreign corporation for a taxable year shall be, except as provided in § 1.970-2, the amount by which—

(i) The amount of its investments in export trade assets at the close of such taxable year, exceeds

(ii) The amount of its investments in export trade assets at the close of the preceding taxable year.

(3) *Decrease in investments in export trade assets.* For purposes of section 970(b) and paragraph (c) of this section, the amount of the decrease in investments in export trade assets of a controlled foreign corporation for a taxable year shall be, except as provided in § 1.970-2, the amount by which—

(i) The amount of its investments in export trade assets at the close of the preceding taxable year, minus

(ii) An amount equal to the excess of recognized losses over recognized gains on sales, exchanges, involuntary conversions, assets or other dispositions, of export trade during the taxable year, exceeds

(iii) The amount of its investments in export trade assets at the close of the taxable year.

For purposes of subdivision (ii) of this subparagraph, recognized losses include a write-down of inventory to lower of cost or market in accordance with a method of inventory valuation established or adopted by or on behalf of such foreign corporation under paragraph (c) of § 1.964-1.

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§ 1.970-2 Elections as to date of determining investments in export trade assets.

(a) *Nature of elections—(1) In general.* In lieu of determining the increase under the provisions of paragraph (d)(2) of § 1.970-1, or the decrease under the provisions of paragraph (d)(3) of § 1.970-