

(e) *Cross references.* See §1.861-9T(b) for the allocation of expense to certain notional principal contracts. For rules relating to the source of income from nonfunctional currency notional principal contracts, see §1.9 88-4T. For rules relating to the taxable amount of notional principal contract income allocable under this section to sources inside or outside the United States, see §1.863-1(c).

[T.D. 8330, 56 FR 1362, Jan. 14, 1991]

**§ 1.864-1 Meaning of sale, etc.**

For purposes of §§1.861 through 1.864-7, the word “sale” includes “exchange”; the word “sold” includes “exchanged”; the word “produced” includes “created”, “fabricated”, “manufactured”, “extracted”, “processed”, “cured”, and “aged”.

[T.D. 6948, 33 FR 5090, Mar. 28, 1968]

**§ 1.864-2 Trade or business within the United States.**

(a) *In general.* As used in part I (section 861 and following) and part II (section 871 and following), subchapter N, chapter 1 of the Code, and chapter 3 (section 1441 and following) of the Code, and the regulations thereunder, the term “engaged in trade or business within the United States” does not include the activities described in paragraphs (c) and (d) of this section, but includes the performance of personal services within the United States at any time within the taxable year except to the extent otherwise provided in this section.

(b) *Performance of personal services for foreign employer—(1) Excepted services.* For purposes of paragraph (a) of this section, the term “engaged in trade or business within the United States” does not include the performance of personal services—

(i) For a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States at any time during the taxable year, or

(ii) For an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual who is temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate gross amount of \$3,000.

(2) *Rules of application.* (i) As a general rule, the term “day”, as used in subparagraph (1) of this paragraph, means a calendar day during any portion of which the nonresident alien individual is physically present in the United States.

(ii) Solely for purposes of applying this paragraph, the nonresident alien individual, foreign partnership, or foreign corporation for which the nonresident alien individual is performing personal services in the United States shall not be considered to be engaged in trade or business in the United States by reason of the performance of such services by such individual.

(iii) In applying subparagraph (1) of this paragraph it is immaterial whether the services performed by the nonresident alien individual are performed as an employee for his employer or under any form of contract with the person for whom the services are performed.

(iv) In determining for purposes of subparagraph (1) of this paragraph whether compensation received by the nonresident alien individual exceeds in the aggregate a gross amount of \$3,000, any amounts received by the individual from an employer as advances or reimbursements for travel expenses incurred on behalf of the employer shall be omitted from the compensation received by the individual, to the extent of expenses incurred, where he was required to account and did account to his employer for such expenses and has met the tests for such accounting provided in §1.162-17 and paragraph (e)(4) of §1.274-5. If advances or reimbursements exceed such expenses, the amount of the excess shall be included as compensation for personal services for purposes of such subparagraph. Pensions and retirement pay attributable to personal services performed in the United States are not to be taken into account for purposes of subparagraph (1) of this paragraph.

(v) See section 7701(a)(5) and § 301.7701-5 of this chapter (Procedure and Administration Regulations) for the meaning of “foreign” when applied to a corporation or partnership.

(vi) As to the source of compensation for personal services, see §§ 1.861-4 and 1.862-1.

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

*Example 1.* During 1967, A, a nonresident alien individual, is employed by the London office of a domestic partnership. A, who uses the calendar year as his taxable year, is temporarily present in the United States during 1967 for 60 days performing personal service in the United States for the London office of the partnership and is paid by that office a total gross salary of \$2,600 for such services. During 1967, A is not engaged in trade or business in the United States solely by reason of his performing such personal services for the London office of the domestic partnership.

*Example 2.* The facts are the same as in example 1, except that A’s total gross salary for the services performed in the United States during 1967 amounts to \$3,500, of which \$2,625 is received in 1967 and \$875 is received in 1968. During 1967, is engaged in trade or business in the United States by reason of his performance of personal services in the United States.

(c) *Trading in stocks or securities.* For purposes of paragraph (a) of this section—

(1) *In general.* The term “engaged in trade or business within the United States” does not include the effecting of transactions in the United States in stocks or securities through a resident broker, commission agent, custodian, or other independent agent. This subparagraph shall apply to any taxpayer, including a broker or dealer in stocks or securities, except that it shall not apply if at any time during the taxable year the taxpayer has an office or other fixed place of business in the United States through which, or by the direction of which, the transactions in stocks or securities are effected. The volume of stock or security transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business within the United States.

(2) *Trading for taxpayer’s own account—*(i) *In general.* The term “engaged in trade or business within the United States” does not include the effecting of transactions in the United States in stocks or securities for the taxpayer’s own account, irrespective of whether such transactions are effected by or through—

(a) The taxpayer himself while present in the United States,

(b) Employees of the taxpayer, whether or not such employees are present in the United States while effecting the transactions, or

(c) A broker, commission agent, custodian, or other agent of the taxpayer, whether or not such agent while effecting the transactions is (1) dependent or independent, or (2) resident, nonresident, or present, in the United States, and irrespective of whether any such employee or agent has discretionary authority to make decisions in effecting such transactions. For purposes of this paragraph, the term “securities” means any note, bond, debenture, or other evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing; and the effecting of transactions in stocks or securities includes buying, selling (whether or not by entering into short sales), or trading in stocks, securities, or contracts or options to buy or sell stocks or securities, on margin or otherwise, for the account and risk of the taxpayer, and any other activity closely related thereto (such as obtaining credit for the purpose of effectuating such buying, selling, or trading). The volume of stock or security transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business within the United States. The application of this subdivision may be illustrated by the following example:

*Example.* A, a nonresident alien individual who is not a dealer in stocks or securities, authorizes B, an individual resident of the United States, as his agent to effect transactions in the United States in stocks and securities for the account of A. B is empowered with complete authority to trade in stocks and securities for the account of A and to use his own discretion as to when to

buy or sell for A's account. This grant of discretionary authority from A to B is also communicated in writing by A to various domestic brokerage firms through which A ordinarily effects transactions in the United States in stocks or securities. Under the agency arrangement B has the authority to place orders with the brokers, and all confirmations are to be made by the brokers to B, subject to his approval. The brokers are authorized by A to make payments to B and to charge such payments to the account of A. In addition, B is authorized to obtain and advance the necessary funds, if any, to maintain credits with the brokerage firms. Pursuant to his authority B carries on extensive trading transactions in the United States during the taxable year through the various brokerage firms for the account of A. During the taxable year A makes several visits to the United States in order to discuss with B various aspects of his trading activities and to make necessary changes in his trading policy. A is not engaged in trade or business within the United States during the taxable year solely because of the effecting by B of transactions in the United States in stocks or securities during such year for the account of A.

(ii) *Partnerships.* A nonresident alien individual, foreign partnership, foreign estate, foreign trust, or foreign corporation shall not be considered to be engaged in trade or business within the United States solely because such person is a member of a partnership (whether domestic or foreign) which, pursuant to discretionary authority granted to such partnership by such person, effects transactions in the United States in stocks or securities for the partnership's own account or solely because an employee of such partnership, or a broker, commission agent, custodian, or other agent, pursuant to discretionary authority granted by such partnership, effects transactions in the United States in stocks or securities for the account of such partnership. This subdivision shall not apply, however, to any member of (a) a partnership which is a dealer in stocks or securities or (b) a partnership (other than a partnership in which, at any time during the last half of its taxable year, more than 50 percent of either the capital interest or the profits interest is owned, directly or indirectly, by five or fewer partners who are individuals) the principal business of which is trading in stocks or securities for its own account, if the principal office of

such partnership is in the United States at any time during the taxable year. The principles of subdivision (iii) of this subparagraph for determining whether a foreign corporation has its principal office in the United States shall apply in determining under this subdivision whether a partnership has its principal office in the United States. See section 707(b)(3) and paragraph (b)(3) of § 1.707-1 for rules for determining the extent of the ownership by a partner of a capital interest or profits interest in a partnership. The application of this subdivision may be illustrated by the following examples:

*Example 1.* B, a nonresident alien individual, is a member of partnership X, the members of which are U.S. citizens, nonresident alien individuals, and foreign corporations. The principal business of partnership X is trading in stocks or securities for its own account. Pursuant to discretionary authority granted by B, partnership X effects transactions in the United States in stocks or securities for its own account. Partnership X is not a dealer in stocks or securities, and more than 50 percent of either the capital interest or the profits interest in partnership X is owned throughout its taxable year by five or fewer partners who are individuals. B is not engaged in trade or business within the United States solely by reason of such effecting of transactions in the United States in stocks or securities by partnership X for its own account.

*Example 2.* The facts are the same as in example 1, except that not more than 50 percent of either the capital interest or the profits interest in partnership X is owned throughout the taxable year by five or fewer partners who are individuals. However, partnership X does not maintain its principal office in the United States at any time during the taxable year. B is not engaged in trade or business within the United States solely by reason of the trading in stocks or securities by partnership X for its own account.

*Example 3.* The facts are the same as in example 1, except that, pursuant to discretionary authority granted by partnership X, domestic broker D effects transactions in the United States in stocks or securities for the account of partnership X. B is not engaged in trade or business in the United States solely by reason of such trading in stocks or securities for the account of partnership X.

(iii) *Dealers in stocks or securities and certain foreign corporations.* This subparagraph shall not apply to the effecting of transactions in the United States for the account of (a) a dealer in

stocks or securities or (b) a foreign corporation (other than a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if the principal office of such corporation is in the United States at any time during the taxable year. Whether a foreign corporation's principal office is in the United States for this purpose is to be determined by comparing the activities (other than trading in stocks or securities) which the corporation conducts from its office or other fixed place of business located in the United States with the activities it conducts from its offices or other fixed places of business located outside the United States. For purposes of this subdivision, a foreign corporation is considered to have only one principal office, and an office of such corporation will not be considered to be its principal office merely because it is a statutory office of such corporation. For example, a foreign corporation which carries on most or all of its investment activities in the United States but maintains a general business office or offices outside the United States in which its management is located will not be considered as having its principal office in the United States if all or a substantial portion of the following functions is carried on at or from an office or offices located outside the United States:

- (1) Communicating with its shareholders (including the furnishing of financial reports),
- (2) Communicating with the general public,
- (3) Soliciting sales of its own stock,
- (4) Accepting the subscriptions of new stockholders,
- (5) Maintaining its principal corporate records and books of account,
- (6) Auditing its books of account,
- (7) Disbursing payments of dividends, legal fees, accounting fees, and officers' and directors' salaries,
- (8) Publishing or furnishing the offering and redemption price of the shares of stock issued by it,
- (9) Conducting meetings of its shareholders and board of directors, and
- (10) Making redemptions of its own stock.

The application of this subdivision may be illustrated by the following examples:

*Example 1.* (a) Foreign corporation X (not a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a personal holding company) was organized to sell its shares to nonresident alien individuals and foreign corporations and to invest the proceeds from the sale of such shares in stocks or securities in the United States. Foreign corporation X is engaged primarily in the business of investing, reinvesting, and trading in stocks or securities for its own account.

(b) For a period of three years, foreign corporation X irrevocably authorizes domestic corporation Y to exercise its discretion in effecting transactions in the United States in stocks or securities for the account and risk of foreign corporation X. Foreign corporation X issues a prospectus in which it is stated that its funds will be invested pursuant to an investment advisory contract with domestic corporation Y and otherwise advertises its services. Shares of foreign corporation X are sold to nonresident aliens and foreign corporations who are customers of the United States brokerage firms unrelated to domestic corporation Y or foreign corporation X. The principal functions performed for foreign corporation X by domestic corporation Y are the rendering of investment advice and the effecting of transactions in the United States in stocks or securities for the account of foreign corporation X. Moreover, domestic corporation Y occasionally communicates with prospective foreign investors in foreign corporation X (through speaking engagements abroad by management of domestic corporation Y, and otherwise) for the purpose of explaining the investment techniques and policies used by domestic corporation Y in investing the funds of foreign corporation X. However, domestic corporation Y does not participate in the day-to-day conduct of other business activities of foreign corporation X.

(c) Foreign corporation X maintains a general business office or offices outside the United States in which its management is permanently located and from which it carries on, except to the extent noted heretofore, the functions enumerated in (b)(1) through (10) of this subdivision. The management of foreign corporation X at all times retains the independent power to cancel the investment advisory contract with domestic corporation Y subject to the contractual limitations contained therein and is in all other respects independent of the management of domestic corporation Y. The managing personnel of foreign corporation X communicate on a regular basis with domestic corporation Y, and periodically visit the

offices of domestic corporation Y, in connection with the business activities of foreign corporation X.

(d) The principal office of foreign corporation X will not be considered to be in the United States; and, therefore, foreign corporation X is not engaged in trade or business within the United States solely by reason of its relationship with domestic corporation Y.

*Example 2.* The facts are the same as in example 1 except that, in lieu of having the investment advisory contract with domestic corporation Y, foreign corporation X has an office in the United States in which its employees perform the same functions as are performed by domestic corporation Y in example 1. Foreign corporation X is not engaged in trade or business within the United States during the taxable year solely because the employees located in its United States office effect transactions in the United States in stocks or securities for the account of that corporation.

(iv) *Definition of dealer in stocks or securities—(a) In general.* For purposes of this subparagraph, a dealer in stocks or securities is a merchant of stocks or securities, with an established place of business, regularly engaged as a merchant in purchasing stocks or securities and selling them to customers with a view to the gains and profits that may be derived therefrom. Persons who buy and sell, or hold, stocks or securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations, members of partnerships, or fiduciaries, who in their individual capacities buy and sell, or hold, stocks or securities for investment or speculation are not dealers in stocks or securities within the meaning of this subparagraph solely by reason of that activity. In determining under this subdivision whether a person is a dealer in stocks or securities such person's transactions in stocks or securities effected both in and outside the United States shall be taken into account.

(b) *Underwriting syndicates and dealers trading for others.* A foreign person who otherwise may be considered a dealer in stocks or securities under (a) of this subdivision shall not be considered a dealer in stocks or securities for purposes of this subparagraph—

(1) Solely because he acts as an underwriter, or as a selling group mem-

ber, for the purpose of making a distribution of stocks or securities of a domestic issuer to foreign purchasers of such stocks or securities, irrespective of whether other members of the selling group distribute the stocks or securities of the domestic issuer to domestic purchasers, or

(2) Solely because of transactions effected in the United States in stocks or securities pursuant to his grant of discretionary authority to make decisions in effecting those transactions, if he can demonstrate to the satisfaction of the Commissioner that the broker, commission agent, custodian, or other agent through whom the transactions were effected acted pursuant to his written representation that the funds in respect of which such discretion was granted were the funds of a customer who is neither a dealer in stocks or securities, a partnership described in subdivision (ii)(b) of this subparagraph, or a foreign corporation described in subdivision (iii)(b) of this subparagraph.

For purposes of this (b), a foreign person includes a nonresident alien individual, a foreign corporation, or a partnership any member of which is a nonresident alien individual or a foreign corporation. This (b) shall apply only if the foreign person at no time during the taxable year has an office or other fixed place of business in the United States through which, or by the direction of which, the transactions in stocks or securities are effected.

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

*Example 1.* Foreign corporation X is a member of an underwriting syndicate organized to distribute stock issued by domestic corporation Y. Foreign corporation X distributes the stock of domestic corporation Y to foreign purchasers only. Domestic corporation M is syndicate manager of the underwriting syndicate and, pursuant to the terms of the underwriting agreement, reserves the right to sell certain quantities of the underwritten stock on behalf of all the members of the syndicate so as to engage in stabilizing transactions and to take certain other actions which may result in the realization of profit by all members of the underwriting syndicate. Foreign corporation X is not engaged in trade or business within the United States solely by reason of its participation as a member of such underwriting syndicate for the purpose of distributing the stock of

domestic corporation Y to foreign purchasers or by reason of the exercise by M corporation of its discretionary authority as manager of such syndicate.

*Example 2.* Foreign corporation Y, a calendar year taxpayer, is a bank which trades in stocks or securities both for its own account and for the account of others. During 1967 foreign corporation Y authorizes domestic corporation M, a broker, to exercise its discretion in effecting transactions in the United States in stocks or securities for the account of B, a nonresident alien individual who has a trading account with foreign corporation Y. Foreign corporation Y furnishes a written representation to domestic corporation M to the effect that the funds in respect of which foreign corporation Y has authorized domestic corporation M to use its discretion in trading in the United States in stocks or securities are not funds in respect of which foreign corporation Y is trading for its own account but are the funds of one of its customers who is neither a dealer in stocks or securities, a partnership described in subdivision (ii)(b) of this subparagraph, or a foreign corporation described in subdivision (iii)(b) of this subparagraph. Pursuant to the discretionary authority so granted, domestic corporation M effects transactions in the United States during 1967 in stocks or securities for the account of the customer of foreign corporation Y. At no time during 1967 does foreign corporation Y have an office or other fixed place of business in the United States through which, or by the direction of which, such transactions in stocks or securities are effected by domestic corporation M. During 1967 foreign corporation Y is not engaged in trade or business within the United States solely by reason of such trading in stocks or securities during such year by domestic corporation M for the account of the customer of foreign corporation Y. Copies of the written representations furnished to domestic corporation M should be retained by foreign corporation Y for inspection by the Commissioner, if inspection is requested.

(d) *Trading in commodities.* For purposes of paragraph (a) of this section—

(1) *In general.* The term “engaged in trade or business within the United States” does not include the effecting of transactions in the United States in commodities (including hedging transactions) through a resident broker, commission agent, custodian, or other independent agent if (i) the commodities are of a kind customarily dealt in on an organized commodity exchange, such as a grain futures or a cotton futures market, (ii) the transaction is of a kind customarily consummated at such place, and (iii) the taxpayer at no

time during the taxable year has an office or other fixed place of business in the United States through which, or by the direction of which, the transactions in commodities are effected. The volume of commodity transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business in the United States.

(2) *Trading for taxpayer's own account—(i) In general.* The term “engaged in trade or business within the United States” does not include the effecting of transactions in the United States in commodities (including hedging transactions) for the taxpayer's own account if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place. This rule shall apply irrespective of whether such transactions are effected by or through—

(a) The taxpayer himself while present in the United States,

(b) Employees of the taxpayer, whether or not such employees are present in the United States while effecting the transactions, or

(c) A broker, commission, agent, custodian, or other agent of the taxpayer, whether or not such agent while effecting the transactions is (1) dependent or independent, or (2) resident, nonresident, or present, in the United States, and irrespective of whether any such employee or agent has discretionary authority to make decisions in effecting such transactions. The volume of commodity transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business within the United States. This subparagraph shall not apply to the effecting of transactions in the United States for the account of a dealer in commodities.

(ii) *Partnerships.* A nonresident alien individual, foreign partnership, foreign estate, foreign trust, or foreign corporation shall not be considered to be engaged in trade or business within the United States solely because such person is a member of a partnership

(whether domestic or foreign) which, pursuant to discretionary authority granted to such partnership by such person, effects transactions in the United States in commodities for the partnership's account or solely because an employee of such partnership, or a broker, commission agent, custodian, or other agent, pursuant to discretionary authority granted by such partnership, effects transactions in the United States in commodities for the account of such partnership. This subdivision shall not apply to any member of a partnership which is a dealer in commodities.

(iii) *Illustration.* The application of this subparagraph may be illustrated by the following example:

*Example.* Foreign corporation X, a calendar year taxpayer, is engaged as a merchant in the business of purchasing grain in South America and selling such cash grain outside the United States under long-term contracts for delivery in foreign countries. Foreign corporation X consummates a sale of 100,000 bushels of cash grain in February 1967 for July delivery to Sweden. Because foreign corporation X does not actually own such grain at the time of the sales transaction, such corporation buys as a hedge a July "futures contract" for delivery of 100,000 bushels of grain, in order to protect itself from loss by reason of a possible rise in the price of grain between February and July. The "futures contract" is ordered through domestic corporation Y, a futures commission merchant registered under the Commodity Exchange Act. Foreign corporation X is not engaged in trade or business within the United States during 1967 solely by reason of its effecting of such futures contract for its own account through domestic corporation Y.

(3) *Definition of commodity.* For purposes of section 864(b)(2)(B) and this paragraph the term "commodities" does not include goods or merchandise in the ordinary channels of commerce.

(e) *Other rules.* The fact that a person is not determined by reason of this section to be not engaged in trade or business with the United States is not to be considered a determination that such person is engaged in trade or business within the United States. Whether or not such person is engaged in trade or business within the United States shall be determined on the basis of the facts and circumstances in each case. For other rules relating to the determination of whether a taxpayer is engaged

in trade or business in the United States see section 875 and the regulations thereunder.

(f) *Effective date.* The provisions of this section shall apply only in the case of taxable years beginning after December 31, 1966.

[T.D. 6948, 33 FR 5090, Mar. 28, 1968, as amended by T.D. 7378, 40 FR 45435, Oct. 2, 1975]

**§ 1.864-3 Rules for determining income effectively connected with U.S. business of nonresident aliens or foreign corporations.**

(a) *In general.* For purposes of the Internal Revenue Code, in the case of a nonresident alien individual or a foreign corporation that is engaged in a trade or business in the United States at any time during the taxable year, the rules set forth in §§ 1.864-4 through 1.864-7 and this section shall apply in determining whether income, gain, or loss shall be treated as effectively connected for a taxable year beginning after December 31, 1966, with the conduct of a trade or business in the United States. Except as provided in sections 871 (c) and (d) and 882 (d) and (e), and the regulations thereunder, in the case of a nonresident alien individual or a foreign corporation that is at no time during the taxable year engaged in a trade or business in the United States, no income, gain, or loss shall be treated as effectively connected for the taxable year with the conduct of a trade or business in the United States. The general rule prescribed by the preceding sentence shall apply even though the income, gain, or loss would have been treated as effectively connected with the conduct of a trade or business in the United States if such income or gain had been received or accrued, or such loss had been sustained, in an earlier taxable year when the taxpayer was engaged in a trade or business in the United States. In applying §§ 1.864-4 through 1.864-7 and this section, the determination whether an item of income, gain, or loss is effectively connected with the conduct of a trade or business in the United States shall not be controlled by any administrative, judicial, or other interpretation made under the laws of any foreign country.