

regulations under those sections apply to a FSC and its controlled group.

[T.D. 8126, 52 FR 6435, Mar. 3, 1987]

**§ 1.922-1 Requirements that a corporation must satisfy to be a FSC or a small FSC.**

(a) *FSC requirements.*

*Q-1.* What are the requirements that a corporation must satisfy to be an FSC?

*A-1.* A corporation must satisfy all of the requirements of section 922(a).

(b) *Small FSC requirements.*

*Q-2.* What are the requirements that a corporation must satisfy to be a small FSC?

*A-2.* A corporation must satisfy all of the requirements of sections 922(a)(1) and (b).

(c) *Definition of corporation.*

*Q-3.* What type of entity is considered a corporation for purposes of qualifying as an FSC or a small FSC under section 922?

*A-3.* A foreign entity that is classified as a corporation under section 7701(a)(3) (other than an insurance company) is considered a corporation for purposes of this requirement.

(d) *Eligible possession.*

*Q-4.* For purposes of meeting the place of incorporation requirement of section 922(a)(1)(A), what is a possession of the United States?

*A-4.* For purposes of section 922(a)(1)(A), the possessions of the United States are Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands of the United States ("eligible possessions"). Puerto Rico, although a possession for certain tax purposes, does not qualify as a jurisdiction in which a FSC or small FSC may be incorporated.

(e) *Qualifying countries.*

*Q-5.* For purposes of meeting the place of incorporation requirement of section 922(a)(1)(A), what is a foreign country and which foreign countries meet the requirements of section 927(e)(3)?

*A-5.* (i) A foreign country is a jurisdiction outside the 50 states, the District of Columbia, the Commonwealth of Puerto Rico, and the possessions of the United States. (ii) A list of the foreign countries that meet the require-

ments of section 927(e)(3) ("qualifying countries") will be published from time to time in the FEDERAL REGISTER and the Internal Revenue Bulletin. A corporation is considered to be created or organized under the laws of a foreign country that meets the requirements of section 927(e)(3) only if the foreign country is a party to (A) an exchange of information agreement under the Caribbean Basin Economic Recovery Act (Code section 274(h)((6)(C))), or (B) a bilateral income tax treaty with the United States if the Secretary certifies that the exchange of information program under the treaty carries out the purposes of the exchange of information requirements of the FSC legislation as set forth in Code section 927(e)(3) and if the corporation is covered under exchange of information program under subdivision (A) or (B).

(f) *Number of shareholders.*

*Q-6.* Who is counted as a shareholder of a corporation for purposes of determining whether a corporation meets the limitation on the number of shareholders to no more than 25 under section 922(a)(1)(B)?

*A-6.* Solely for purposes of the limitation on the number of shareholders, the following rules apply:

(i) In general, an individual who owns an interest in stock of the corporation is counted as a shareholder. In the case of joint owners, each joint owner is counted as a shareholder. A member of a corporation's board of directors who holds qualifying shares that are required to be owned by a resident of the country of incorporation is not counted as a shareholder.

(ii) A corporation that owns an interest in stock of the corporation is counted as a single shareholder.

(iii) An estate that owns an interest in stock of the corporation is counted as a single shareholder. If the limitation on number of shareholders is not satisfied by reason of the closing of an estate, the FSC will continue to qualify for the taxable year of the FSC in which the estate is closed.

(iv) A trust is not counted as a shareholder. In the case of a trust all of which is treated as owned by one or more persons under sections 671 through 679, those persons are counted as shareholders. In the case of all other

trusts, a beneficiary is counted as a shareholder.

(v) A partnership is not counted as a shareholder. A general or limited partner is counted as a shareholder if it is a corporation, an individual, or an estate, under the rules contained in subdivisions (i) through (iii). A general or limited partner is not counted as a shareholder if it is a partnership or a trust; the rules contained in subdivision (iv) and this subdivision (v) apply to the determination of who is counted as a shareholder.

(g) *Class of stock.*

**Q-7.** What is preferred stock for purposes of determining whether a corporation satisfies the requirement under section 922(a)(1)(C) that no preferred stock be outstanding?

**A-7.** Preferred stock is stock that is limited and preferred as to dividends or distributions in liquidation.

**Q-8.** Can a corporation have outstanding more than one class of common stock?

**A-8.** Yes. However, the rights of a class of stock will be disregarded if the right has the effect of avoidance of Federal income tax. For instance, dividend rights may not be used to direct dividends from exempt foreign trade income to shareholders that have taxable income and to direct other dividends to shareholders that have met operating loss carryovers.

(h) *Office.*

**Q-9.** What is an office for purposes of determining whether a corporation satisfies the requirement of section 922(a)(1)(D)(i)?

**A-9.** An office is a place for the transaction of the business of the corporation. To be an office a place must meet all of the following requirements;

(i) *It must have a fixed location.* A transient location is not a fixed location.

(ii) *It must be a building or a portion of a building consisting of at least one room.* A room is a partitioned part of the inside of a building. The building or portion thereof used as the corporation's office must be large enough to accommodate the equipment required in subdivision (iii) of this answer 9 and the activity required in subdivision (iv) of this answer 9. However, an office is not limited to a room with communication

equipment or an adjacent room. Non-contiguous space within the same building will also constitute an office if it is equipped for the retention of the documentation required to be stored by the FSC and if access to the necessary communication equipment is available for use by the FSC.

(iii) *It must be equipped for the performance of the corporation's business.* An office must be equipped for the communication and retention of information and must be supplied with communication services.

(iv) *It must be regularly used for some business activity of the corporation.* A corporation's business activities must include the maintenance of the documentation described in Q&A 12 of this section. These documents need not be prepared at the office. Any person, whether or not related to the corporation, may perform the business activities of the corporation at the office if the activity is performed pursuant to a contract, oral or written, for the performance of the activity on behalf of the corporation.

(v) *It must be operated, and owned or leased, by the corporation or by a person, whether or not related to the corporation, under contract to the corporation.*

(vi) *It must be maintained by the corporation or by a person, whether or not related, to the corporation, under contract to the corporation at all times during the taxable year.* In the case of a corporation newly organized as a FSC, thirty days may elapse between the time the corporation is organized as a FSC (*i.e.*, the first day for which the FSC election is effective) and the time an office is maintained by the corporation or a person under contract with the corporation. A place that meets the requirements in subdivision (i) through (vi) of this answer 9 can also be used for activities that are unrelated to the business activity of the corporation.

**Q-10.** Can a corporation locate an office in any foreign country if it has at least one office in a U.S. possession or in a foreign country that meets the requirements of section 927 (e)(3) as provided Q&A 5 of this section?

**A-10.** Yes.

**Q-11.** Must a corporation locate the office that is required under section

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922(a)(1)(D)(i) in the country or possession of its incorporation?

*A-11.* No.

(i) *Documentation.*

*Q-12.* What documentation must be maintained at the corporation's office for purposes of section 922(a)(1)(D)(ii)?

*A-12.* At least the following documentation must be maintained at the corporation's office under section 922(a)(1)(D)(ii):

(i) The quarterly income statements, a final year-end income statement and a year-end balance sheet of the FSC; and

(ii) All final invoices (or a summary of them) or statements of account with respect to (A) sales by the FSC, and (B) sales by a related person if the FSC realizes income with respect to such sales. A final invoice is an invoice upon which payment is made by the customer. A invoice must contain, at a minimum, the customer's name or identifying number and, with respect to the transaction or transactions, the date, product or product code or service of service code, quantity, price, and amount due. In the alternative, a document will be acceptable as a final invoice even though it does not include all of the above listed information if the FSC establishes that the document is considered to be a final invoice under normal commercial practices. An invoice forwarded to the customer after payment has been tendered or received pursuant to a letter of credit, as a receipt for payment, satisfies this definition. A single final invoice may cover more than one transaction with a customer.

(iii) A summary of final invoices may be in any reasonable form provided that the summary contains all substantive information from the invoices. All substantive information includes the customer's name or identifying number, the invoice number, date, product or product code, and amount owed. In the alternative, all substantive information includes a summary of the information that is included on documents considered to be final invoices under normal commercial practice. A statement of account is any summary statement forwarded to a customer to inform of, or confirm, the status of transactions occurring within

an accounting period during a taxable year that is not less than one month. A statement of account must contain, at a minimum, the customer's name or identifying number, date of the statement of account and the balance due (even if the balance due is zero) as of the last day of the accounting period covered by the statement of account. In the alternative, a document will be accepted as a statement of account even though it does not include all of the above listed information if the FSC establishes that the document is considered a statement of account under normal commercial practice. For these purposes, a document will be considered to be a statement of account under normal commercial practice if it is sent to domestic as well as to export customers in order to inform the customers of the status of transactions during an accounting period. With regard to quarterly income statements, a reasonable estimate of the FSC's income and expense items will be acceptable. If the FSC is a commission FSC, 1.83% of the related supplier's gross receipts will be considered a reasonable estimate of the FSC's income. The documents required by this Q&A 12 need not be prepared by the FSC. In addition they need not be prepared at the FSC's office.

(iv) The FSC will satisfy the requirement that the documents be maintained at its office even if not all final invoices (or summaries) or statements of account or items to be included on statements of account are maintained at its office as long as it makes a good faith effort to do so and provided that any failure to maintain the required documents is cured within a reasonable time of discovery of the failure.

*Q-13.* If the required documents are not prepared at the FSC's office, by what date must the documents be maintained at its office?

*A-13.* With regard to the applicable quarters of years prior to March 3, 1987, the quarterly income statements, final invoices (or summaries), or statements of account and the year-end balance sheet must be maintained at the FSC's office no later than the due date, including extensions, of the FSC tax return for the applicable taxable year in which the period ends. With regard to

the applicable quarters or years ending after March 3, 1987, the quarterly income statements for the first three quarters of the FSC year must be maintained at the FSC's office no later than 90 days after the end of the quarter. The quarterly income statement for the fourth quarter of the FSC year, the final year-end income statement, the year-end balance sheet, and the final invoices (or summaries) or statements of account must be maintained at the FSC's office no later than the due date, including extensions, of the FSC tax return for the applicable taxable year.

*Q-14.* In what form must the documentation required under section 922(a)(1)(D)(ii) be maintained?

*A-14.* The documentation required to be maintained by the office may be originals or duplicates and may be in any form that qualifies as a record under Rev. Rul. 71-20, 1971-1 C.B. 392. Therefore, documentation may be maintained in the form of punch cards, magnetic tapes, disks, and other machine-sensible media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's automatic data processing system. The corporation need not maintain at its office equipment capable of reading the machine-sensible media. That equipment, however, must be situated in a location that is readily accessible to the corporation. The equipment need not be owned by the corporation.

*Q-15.* How long must the documentation required under section 922(a)(1)(D)(ii) be maintained?

*A-15.* The documentation required under section 922(a)(1)(D)(ii) for a taxable year must be maintained at the FSC's office described in section 922(a)(1)(D)(i) until the period of limitations for assessment of tax for the taxable year has expired under section 6501.

*Q-16.* Under what circumstances will a corporation be considered to satisfy the requirement of section 922(a)(1)(D)(iii) that it maintain the records it is required to keep under section 6001 at a location within the United States?

*A-16.* A corporation will be considered to satisfy this requirement if the

records required under section 6001 are kept by any person at any location in the United States provided that the records are retained in accordance with section 6001 and the regulations thereunder.

(j) *Board of directors.*

*Q-17.* What is a corporation's "board of directors" for purposes of the requirement under section 922(a)(1)(E) that, at all times during the taxable year, the corporation must have a board of directors which includes at least one individual who is not a resident of the United States?

*A-17.* The "board of directors" is the body that manages and directs the corporation according to the law of the qualifying country or eligible possession under the laws of which the corporation was created or organized.

*Q-18.* Can the member of the board of directors who is a nonresident of the United States be a citizen of the United States?

*A-18.* Yes. For purposes of meeting the requirement under section 922(a)(1)(E), the member of the board who cannot be a United States resident can be a United States citizen. The principles of section 7701(b) shall be used to determine whether a United States citizen is a United States resident.

*Q-19.* If the only member of the board of directors who is not a resident of the United States dies, or resigns, is removed from the board or becomes a resident of the United States will the corporation be considered to fail the requirement under section 922(a)(1)(E)?

*A-19.* If the corporation appoints a new member who is a nonresident of the United States to the board within 30 days after the death, resignation or removal of the former nonresident member, the corporation will be considered to satisfy the requirement under section 922(a)(1)(E). Also, the corporation will be considered to satisfy the requirement under section 922(a)(1)(E) if the corporation appoints a new member who is a nonresident of the United States to the board within 30 days after the corporation has knowledge, or reason to know, that the board's former nonresident member was in fact a resident of the United States.

*Q-20.* Is a nonresident alien individual who elects to be treated as a resident of the United States for a taxable year under section 6013(g) considered a nonresident of the United States for purposes of the requirement under section 922(a)(1)(E)?

*A-20.* Yes.

*Q-21.* Will the requirement that a FSC's board of directors have a nonresident member at all times during the taxable year be satisfied if the nonresident member is elected or appointed to the board of directors no later than 30 days after the first day for which the FSC election is effective?

*A-21.* Yes.

[T.D. 8127, 52 FR 6470, Mar. 3, 1987]

**§ 1.923-1T Temporary regulations; exempt foreign trade income.**

(a) *Foreign trade income.* Foreign trade income of a FSC is the FSC's gross income attributable to its foreign trading gross receipts. (Any further reference to a FSC in this section shall include a small FSC unless indicated otherwise.) If the FSC is the principal on the sale of export property which it purchased from a related supplier, the FSC's gross income is determined by subtracting from its foreign trading gross receipts the transfer price determined under the transfer pricing methods of section 925(a). If the FSC is the commission agent on the sale of export property by its related supplier, the FSC's gross income is the commission paid or payable by the related supplier to the FSC with respect to the transactions that would have generated foreign trading gross receipts had the FSC been the principal on the transaction. See § 1.925(a)-1T(f) *Examples 1 and 6* for illustrations of the computation of a FSC's foreign trade income, exempt foreign trade income and taxable income.

(b) *Exempt foreign trade income—(1) Determination.* (i) If a FSC uses either of the two administrative pricing rules, provided for by sections 925(a)(1) and (2), to determine its income from a transaction, or group of transactions, to which section 925 applies (see § 1.925(a)-1T(b)(2) (ii) and (iii)), 15/23 of the foreign trade income that it earns from the transaction, or group of transactions, will be exempt foreign

trade income. If a FSC has a non-corporate shareholder (shareholders), 16/23 of its foreign trade income attributable to the noncorporate shareholder's (shareholders') proportionate interest in the FSC will be exempt foreign trade income. See section 291(a)(4).

(ii) If a FSC does not use the administrative pricing rules to determine its income from a transaction, or group of transactions, which gives rise to foreign trade income, 30 percent of its foreign trade income will be exempt foreign trade income. If a FSC has a non-corporate shareholder (shareholders), 32 percent of its foreign trade income attributable to the non-corporate shareholder's (shareholders') proportionate interest in the FSC will be exempt foreign trade income. See section 291(a)(4).

(iii) Exempt foreign trade income so determined under subdivisions (1)(i) and (ii) of this paragraph is treated as foreign source income which is not effectively connected with the conduct of a trade or business within the United States. See section 921(a).

(2) *Special rule for foreign trade income allocable to a qualified cooperative.* (i) Pursuant to section 923(a)(4), if a qualified cooperative is a shareholder of a FSC, the FSC's non-exempt foreign trade income determined by use of either of the administrative pricing methods of section 925(a)(1) or (2) which is allocable to the marketing of agricultural or horticultural products, or the providing of related services, for any taxable year will be treated as exempt foreign trade income to the extent that it is distributed to the qualified cooperative shareholder. A qualified cooperative is defined as any organization to which chapter 1, subchapter T, part 1 of the Code applies. See section 1381(a).

(ii) This special rule of section 923(a)(4) shall apply only if the distribution is made before the due date under section 6072(b), including extensions, for filing the FSC's income tax return for that year. Any distribution which satisfies this requirement will be treated as made on the last day of the FSC's taxable year. In addition, this special rule shall apply only if the income of the cooperative is based on arm's length transactions between the