

foreign corporations not availed of to reduce taxes,

(iv) Any income derived in the active conduct of a trade or business which is excluded under section 954(c)(3), or

(v) Any income received from related persons which is excluded under section 954(c)(4).

This subparagraph shall apply to the foreign corporation's entire subpart F income for the taxable year determined under section 952(a), even though no amount is included in the gross income of a U.S. shareholder under section 951(a) with respect to that subpart F income because of the minimum distribution provisions of section 963(a) or because of the reduction under section 970(a) with respect to an export trade corporation. This subparagraph shall apply only to a foreign corporation which is a controlled foreign corporation within the meaning of section 957 and the regulations thereunder. The application of this subparagraph may be illustrated by the following examples:

*Example 1.* Controlled foreign corporation M, incorporated under the laws of foreign country X, is engaged in the business of purchasing and selling merchandise manufactured in foreign country Y by an unrelated person. M negotiates sales, through its sales office in the United States, of its merchandise for use outside of country X. These sales are made outside the United States, and the merchandise is sold for use outside the United States. No office maintained by M outside the United States participates materially in the sales made through its U.S. sales office. These activities constitute the only activities of M. During the taxable year M derives \$100,000 income from these sales made through its U.S. sales office, and all of such income is foreign base company sales income by reason of section 954(d)(2) and paragraph (b) of § 1.954-3. The entire \$100,000 is also subpart F income, determined under section 952(a). In addition, all of this income would, without reference to section 864(c)(4)(D)(ii) and this subparagraph, be treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by M. Through its entire taxable year 60 percent of the one class of stock of M is owned within the meaning of section 958(a) by U.S. shareholders, as defined in section 951(b), and 40 percent of its one class of stock is owned within the meaning of section 958(a) by persons who are not U.S. shareholders, as defined in section 951(b). Although only \$60,000 of the subpart F income of M for the taxable

year is includible in the income of the U.S. shareholders under section 951(a), the entire subpart F income of \$100,000 constitutes income which, by reason of section 864(c)(4)(D)(ii) and this subparagraph, is not effectively connected for the taxable year with the conduct of a trade or business in the United States by M.

*Example 2.* The facts are the same as in example 1 except that the foreign base company sales income amounts to \$150,000 determined in accordance with paragraph (d)(3)(i) of § 1.954-1, and that M also has gross income from sources without the United States of \$50,000 from sales, through its sales office in the United States, of merchandise for use in country X. These sales are made outside the United States. All of this income would, without reference to section 864(c)(4)(D)(ii) and this subparagraph, be treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by M. Since the foreign base company income of \$150,000 amounts to 75 percent of the entire gross income of \$200,000, determined as provided in paragraph (d)(3)(ii) of § 1.954-1, the entire \$200,000 constitutes foreign base company income under section 954(b)(3)(B). Assuming that M has no amounts to be taken into account under paragraphs (1), (2), (4), and (5) of section 954(b), the \$200,000 is also subpart F income, determined under section 952(a). This subpart F income of \$200,000 constitutes income which, by reason of section 864(c)(4)(D)(ii) and this subparagraph, is not effectively connected for the taxable year with the conduct of a trade or business in the United States by M.

(3) *Interest on certain deposits.* Interest which, by reason of section 861(a)(1)(A) (relating to interest on deposits with banks, savings and loan associations, and insurance companies paid or credited before January 1, 1976) and paragraph (c) of § 1.864-4, is determined to be income from sources without the United States because it is not effectively connected for the taxable year with the conduct of a trade or business in the United States by the non-resident alien individual or foreign corporation.

[T.D. 7216, 37 FR 23429, Nov. 3, 1972, as amended by T.D. 7893, 48 FR 22507, May 19, 1983; T.D. 8735, 62 FR 53501, Oct. 14, 1997]

**§ 1.864-6 Income, gain, or loss attributable to an office or other fixed place of business in the United States.**

(a) *In general.* Income, gain, or loss from sources without the United States

which is specified in paragraph (b) of § 1.864-5 and received by a nonresident alien individual or a foreign corporation engaged in a trade or business in the United States at some time during a taxable year beginning after December 31, 1966, shall be treated as effectively connected for the taxable year with the conduct of a trade or business in the United States only if the income, gain, or loss is attributable under paragraphs (b) and (c) of this section to an office or other fixed place of business, as defined in § 1.864-7, which the taxpayer has in the United States at some time during the taxable year.

(b) *Material factor test*—(1) *In general.* For purposes of paragraph (a) of this section, income, gain, or loss is attributable to an office or other fixed place of business which a nonresident alien individual or a foreign corporation has in the United States only if such office or other fixed place of business is a material factor in the realization of the income, gain, or loss, and if the income, gain, or loss is realized in the ordinary course of the trade or business carried on through that office or other fixed place of business. For this purpose, the activities of the office or other fixed place of business shall not be considered to be a material factor in the realization of the income, gain, or loss unless they provide a significant contribution to, by being an essential economic element in, the realization of the income, gain, or loss. Thus, for example, meetings in the United States of the board of directors of a foreign corporation do not of themselves constitute a material factor in the realization of income, gain, or loss. It is not necessary that the activities of the office or other fixed place of business in the United States be a major factor in the realization of the income, gain, or loss. An office or other fixed place of business located in the United States at some time during a taxable year may be a material factor in the realization of an item of income, gain, or loss for that year even though the office or other fixed place of business is not present in the United States when the income, gain, or loss is realized.

(2) *Application of material factor test to specific classes of income.* For purposes of paragraph (a) of this section, an of-

fice or other fixed place of business which a nonresident alien individual or a foreign corporation, engaged in a trade or business in the United States at some time during the taxable year, had in the United States, shall be considered a material factor in the realization of income, gain, or loss consisting of—

(i) *Rents, royalties, or gains on sales of intangible property.* Rents, royalties, or gains or losses, from intangible personal property specified in paragraph (b)(1) of § 1.864-5, if the office or other fixed place of business either actively participates in soliciting, negotiating, or performing other activities required to arrange, the lease, license, sale, or exchange from which such income, gain, or loss is derived or performs significant services incident to such lease, license, sale, or exchange. An office or other fixed place of business in the United States shall not be considered to be a material factor in the realization of income, gain, or loss for purposes of this subdivision merely because the office or other fixed place of business conducts one or more of the following activities: (a) Develops, creates, produces, or acquires and adds substantial value to, the property which is leased, licensed, or sold, or exchanged, (b) collects or accounts for the rents, royalties, gains, or losses, (c) exercises general supervision over the activities of the persons directly responsible for carrying on the activities or services described in the immediately preceding sentence, (d) performs merely clerical functions incident to the lease, license, sale, or exchange or (e) exercises final approval over the execution of the lease, license, sale, or exchange. The application of this subdivision may be illustrated by the following examples:

*Example 1.* F, a foreign corporation, is engaged in the active conduct of the business of licensing patents which it has either purchased or developed in the United States. F has a business office in the United States. Licenses for the use of such patents outside the United States are negotiated by offices of F located outside the United States, subject to approval by an officer of such corporation located in the U.S. office. All services which are rendered to F's foreign licensees are performed by employees of F's offices located outside the United States. None of

the income, gain, or loss resulting from the foreign licenses so negotiated by F is attributable to its business office in the United States.

*Example 2.* N, a foreign corporation, is engaged in the active conduct of the business of distributing motion picture films and television programs. N does not distribute such films or programs in the United States. The foreign distribution rights to these films and programs are acquired by N's U.S. business office from the U.S. owners of these films and programs. Employees of N's offices located in various foreign countries carry on in such countries all the solicitations and negotiations for the licensing of these films and programs to licensees located in such countries and provide the necessary incidental services to the licensees. N's U.S. office collects the rentals from the foreign licensees and maintains the necessary records of income and expense. Officers of N located in the United States also maintain general supervision over the employees of the foreign offices, but the foreign employees conduct the day to day business of N outside the United States of soliciting, negotiating, or performing other activities required to arrange the foreign licenses. None of the income, gain, or loss resulting from the foreign licenses so negotiated by N is attributable to N's U.S. office.

(ii) *Dividends or interest, or gains or losses from sales of stock or securities—(a) In general.* Dividends or interest from any transaction, or gains or losses on the sale or exchange of stocks or securities, specified in paragraph (b)(2) of § 1.864-5, if the office or other fixed place of business either actively participates in soliciting, negotiating, or performing other activities required to arrange, the issue, acquisition, sale, or exchange, of the asset from which such income, gain, or loss is derived or performs significant services incident to such issue, acquisition, sale, or exchange. An office or other fixed place of business in the United States shall not be considered to be a material factor in the realization of income, gain, or loss for purposes of this subdivision merely because the office or other fixed place of business conducts one or more of the following activities: (1) Collects or accounts for the dividends, interest, gains, or losses, (2) exercises general supervision over the activities of the persons directly responsible for carrying on the activities or services described in the immediately preceding sentence, (3) performs merely clerical

functions incident to the issue, acquisition, sale, or exchange, or (4) exercises final approval over the execution of the issue, acquisition, sale, or exchange.

(b) *Effective connection of income from stocks or securities with active conduct of a banking, financing, or similar business.* Notwithstanding (a) of this subdivision (ii), the determination as to whether any dividends or interest from stocks or securities, or gain or loss from the sale or exchange of stocks or securities which are capital assets, which is from sources without the United States and derived by a nonresident alien individual or a foreign corporation in the active conduct during the taxable year of a banking, financing, or similar business in the United States, shall be treated as effectively connected for such year with the active conduct of that business shall be made by applying the principles of paragraph (c)(5)(ii) of § 1.864-4 for determining whether income, gain, or loss of such type from sources within the United States is effectively connected for such year with the active conduct of that business.

(c) *Security defined.* For purposes of this subdivision (ii), a security is any bill, note, bond, debenture, or other evidence of indebtedness, or any evidence of an interest in, or right to subscribe or to purchase, any of the foregoing items.

(d) *Limitations on application of rules on banking, financing, or similar business—(1) Trading for taxpayer's own account.* The provisions of (b) of this subdivision (ii) apply for purposes of determining when certain income, gain, or loss from stocks or securities is effectively connected with the active conduct of a banking, financing, or similar business in the United States. Any dividends, interest, gain, or loss from sources without the United States which by reason of the application of (b) of this subdivision (ii) is not effectively connected with the active conduct by a foreign corporation of a banking, financing, or similar business in the United States may be effectively connected for the taxable year, under (a) of this subdivision (ii), with the conduct by such taxpayer of a trade or business in the United States which consists of trading in stocks or securities for the taxpayer's own account.

(2) *Other income.* For rules relating to dividends or interest from sources without the United States (other than dividends or interest from, or gain or loss from the sale or exchange of, stocks or securities referred to in (b) of this subdivision (ii)) derived in the active conduct of a banking, financing, or similar business in the United States, see (a) of this subdivision (ii).

(iii) *Sale of goods or merchandise through U.S. office.* Income, gain, or loss from sales of goods or merchandise specified in paragraph (b)(3) of § 1.864-5, if the office or other fixed place of business actively participates in soliciting the order, negotiating the contract of sale, or performing other significant services necessary for the consummation of the sale which are not the subject of a separate agreement between the seller and the buyer. The office or other fixed place of business in the United States shall be considered a material factor in the realization of income, gain, or loss from a sale made as a result of a sales order received in such office or other fixed place of business except where the sales order is received unsolicited and that office or other fixed place of business is not held out to potential customers as the place to which such sales orders should be sent. The income, gain, or loss must be realized in the ordinary course of the trade or business carried on through the office or other fixed place of business in the United States. Thus, if a foreign corporation is engaged solely in a manufacturing business in the United States, the income derived by its office in the United States as a result of an occasional sale outside the United States is not attributable to the U.S. office if the sales office of the manufacturing business is located outside the United States. On the other hand, if a foreign corporation establishes a sales office in the United States to sell for consumption in the Western Hemisphere merchandise which the corporation produces in Africa, the income derived by the sales office in the United States as a result of an occasional sale made by it in Europe shall be attributable to the U.S. sales office. An office or other fixed place of business in the United States shall not be considered to be a material factor in the realiza-

tion of income, gain, or loss for purposes of this subdivision merely because of one or more of the following activities: (a) The sale is made subject to the final approval of such office or other fixed place of business, (b) the property sold is held in, and distributed from, such office or other fixed place of business, (c) samples of the property sold are displayed (but not otherwise promoted or sold) in such office or other fixed place of business, or (d) such office or other fixed place of business performs merely clerical functions incident to the sale. Activities carried on by employees of an office or other fixed place of business constitute activities of that office or other fixed place of business.

(3) *Limitation where foreign office is a material factor in realization of income—*

(i) *Goods or merchandise destined for foreign use, consumption, or disposition.* Notwithstanding subparagraphs (1) and (2) of this paragraph, an office or other fixed place of business which a non-resident alien individual or a foreign corporation has in the United States shall not be considered, for purposes of paragraph (a) of this section, to be a material factor in the realization of income, gain, or loss from sales of goods or merchandise specified in paragraph (b)(3) of § 1.864-5 if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business, as defined in § 1.864-7, which such non-resident alien individual or foreign corporation has outside the United States participates materially in the sale. For this purpose an office or other fixed place of business which the taxpayer has outside the United States shall be considered to have participated materially in a sale made through the office or other fixed place of business in the United States if the office or other fixed place of business outside the United States actively participates in soliciting the order resulting in the sale, negotiating the contract of sale, or performing other significant services necessary for the consummation of the sale which are not the subject of a separate agreement between the seller and buyer. An office or other fixed place of business which the taxpayer has outside the United States shall not

be considered to have participated materially in a sale merely because of one or more of the following activities: (a) The sale is made subject to the final approval of such office or other fixed place of business, (b) the property sold is held in, and distributed from, such office or other fixed place of business, (c) samples of the property sold are displayed (but not otherwise promoted or sold) in such office or other fixed place of business, (d) such office or other fixed place of business is used for purposes of having title to the property pass outside the United States, or (e) such office or other fixed place of business performs merely clerical functions incident to the sale.

(ii) *Rules for determining country of use, consumption, or disposition—(a) In general.* As a general rule, personal property which is sold to an unrelated person shall be presumed for purposes of this subparagraph to have been sold for use, consumption, or disposition in the country of destination of the property sold; for such purpose, the occurrence in a country of a temporary interruption in shipment of property shall not cause that country to be considered the country of destination. However, if at the time of a sale of personal property to an unrelated person the taxpayer knew, or should have known from the facts and circumstances surrounding the transaction, that the property probably would not be used, consumed, or disposed of in the country of destination, the taxpayer must determine the country of ultimate use, consumption, or disposition of the property or the property shall be presumed to have been sold for use, consumption, or disposition in the United States. A taxpayer who sells personal property to a related person shall be presumed to have sold the property for use, consumption, or disposition in the United States unless the taxpayer establishes the use made of the property by the related person; once he has established that the related person has disposed of the property, the rules in the two immediately preceding sentences relating to sales to an unrelated person shall apply at the first stage in the chain of distribution at which a sale is made by a related person to an unrelated person. Not-

withstanding the preceding provisions of this subdivision (a), a taxpayer who sells personal property to any person whose principal business consists of selling from inventory to retail customers at retail outlets outside the United States may assume at the time of the sale to that person that the property will be used, consumed, or disposed of outside the United States. For purposes of this (a), a person is related to another person if either person owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term “control” includes any kind of control, whether or not legally enforceable, and however, exercised or exercisable. For illustrations of the principles of this subdivision, see paragraph (a)(3)(iv) of § 1.954-3.

(b) *Fungible goods.* For purposes of this subparagraph, a taxpayer who sells to a purchaser personal property which because of its fungible nature cannot reasonably be specifically traced to other purchasers and to the countries of ultimate use, consumption, or disposition shall, unless the taxpayer establishes a different disposition as being proper, treat that property as being sold, for ultimate use, consumption, or disposition in those countries, and to those other purchasers, in the same proportions in which property from the fungible mass of the first purchaser is sold in the ordinary course of business by such first purchaser. No apportionment is required to be made, however, on the basis of sporadic sales by the first purchaser. This (b) shall apply only in a case where the taxpayer knew, or should have known from the facts and circumstances surrounding the transaction, the manner in which the first purchaser disposes of property from the fungible mass.

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

*Example.* Foreign corporation M has a sales office in the United States during the taxable year through which it sells outside the United States for use in foreign countries industrial electrical generators which such corporation manufactures in a foreign country. M is not a controlled foreign corporation within the meaning of section 957 and the regulations thereunder, and, by reason of its

activities in the United States, is engaged in business in the United States during the taxable year. The generators require specialized installation and continuous adjustment and maintenance services. M has an office in foreign country X which is the only organization qualified to perform these installation, adjustment, and maintenance services. During the taxable year M sells several generators through its U.S. office for use in foreign country Y under sales contracts which also provide for installation, adjustment, and maintenance by its office in country X. The generators are installed in country Y by employees of M's office in country X, who also are responsible for the servicing of the equipment. Since the office of M in country X performs significant services incident to these sales which are necessary for their consummation and are not the subject of a separate agreement between M and the purchaser, the U.S. office of M is not considered to be a material factor in the realization of the income from the sales and, for purposes of paragraph (a) of this section, such income is not attributable to the U.S. office of that corporation.

(c) *Amount of income, gain, or loss allocable to U.S. office*—(1) *In general.* If, in accordance with paragraph (b) of this section, an office or other fixed place of business which a nonresident alien individual or a foreign corporation has in the United States at some time during the taxable year is a material factor in the realization for that year of an item of income, gain, or loss specified in paragraph (b) of § 1.864-5, such item of income, gain, or loss shall be considered to be allocable in its entirety to that office or other fixed place of business. In no case may any income, gain, or loss for the taxable year from sources without the United States, or part thereof, be allocable under this paragraph to an office or other fixed place of business which a nonresident alien individual or a foreign corporation has in the United States if the taxpayer is at no time during the taxable year engaged in a trade or business in the United States.

(2) *Special limitation in case of sales of goods or merchandise through U.S. office.* Notwithstanding subparagraph (1) of this paragraph, in the case of a sale of goods or merchandise specified in paragraph (b)(3) of § 1.864-5, which is not a sale to which paragraph (b)(3)(i) of this section applies, the amount of income which shall be considered to be allocable to the office or other fixed place

of business which the nonresident alien individual or foreign corporation has in the United States shall not exceed the amount which would be treated as income from sources within the United States if the taxpayer had sold the goods or merchandise in the United States. See, for example, section 863(b)(2) and paragraph (b) of § 1.863-3, which prescribes, as available methods for determining the income from sources within the United States, the independent factory or production price method, the gross sales and property apportionment method, and any other method regularly employed by the taxpayer which more clearly reflects taxable income from such sources than those specifically authorized.

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

*Example 1.* Foreign corporation M, which is not a controlled foreign corporation within the meaning of section 957 and the regulations thereunder, manufactures machinery in a foreign country and sells the machinery outside the United States through its sales office in the United States for use in foreign countries. Title to the property which is sold is transferred to the foreign purchaser outside the United States, but no office or other fixed place of business of M in a foreign country participates materially in the sale made through its U.S. office. During the taxable year M derives a total taxable income (determined as though M were a domestic corporation) of \$250,000 from these sales. If the sales made through the U.S. office for the taxable year had been made in the United States and the property had been sold for use in the United States, the taxable income from sources within the United States from such sales would have been \$100,000, determined as provided in section 863 and 882(c) and the regulations thereunder. The taxable income which is allocable to M's U.S. sales office pursuant to this paragraph and which is effectively connected for the taxable year with the conduct of a trade or business within the United States by that corporation is \$100,000.

*Example 2.* Foreign corporation N, which is not a controlled foreign corporation within the meaning of section 957 and the regulations thereunder, has an office in a foreign country which purchases merchandise and sells it through its sales office in the United States for use in various foreign countries, such sales being made outside the United States and title to the property passing outside the United States. No other office of N

participates materially in these sales made through its U.S. office. By reason of its sales activities in the United States, N is engaged in business in the United States during the taxable year. During the taxable year N derives taxable income (determined as though N were a domestic corporation) of \$300,000 from these sales made through its U.S. sales office. If the sales made through the U.S. office for the taxable year had been made in the United States and the property had been sold for use in the United States, the taxable income from sources within the United States from such sales would also have been \$300,000, determined as provided in sections 861 and 882(c) and the regulations thereunder. The taxable income which is allocable to N's U.S. sales office pursuant to this paragraph and which is effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation is \$300,000.

*Example 3.* The facts are the same as in example 2, except that N has an office in a foreign country which participates materially in the sales which are made through its U.S. office. The taxable income which is allocable to N's U.S. sales office is not effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation.

[T.D. 7216, 37 FR 23431, Nov. 3, 1972]

**§ 1.864-7 Definition of office or other fixed place of business.**

(a) *In general.* (1) This section applies for purposes of determining whether a nonresident alien individual or a foreign corporation that is engaged in a trade or business in the United States at some time during a taxable year beginning after December 31, 1966, has an office or other fixed place of business in the United States for purposes of applying section 864(c)(4)(B) and § 1.864-6 to income, gain, or loss specified in paragraph (b) of § 1.864-5 from sources without the United States or has an office or other fixed place of business outside the United States for purposes of applying section 864(c)(4)(B)(iii) and paragraph (b)(3)(i) of § 1.864-6 to sales of goods or merchandise for use, consumption, or disposition outside the United States.

(2) In making a determination under this section due regard shall be given to the facts and circumstances of each case, particularly to the nature of the taxpayer's trade or business and the physical facilities actually required by

the taxpayer in the ordinary course of the conduct of his trade or business.

(3) The law of a foreign country shall not be controlling in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business.

(b) *Fixed facilities—(1) In general.* As a general rule, an office or other fixed place of business is a fixed facility, that is, a place, site, structure, or other similar facility, through which a nonresident alien individual or a foreign corporation engages in a trade or business. For this purpose an office or other fixed place of business shall include, but shall not be limited to, a factory; a store or other sales outlet; a workshop; or a mine, quarry, or other place of extraction of natural resources. A fixed facility may be considered an office or other fixed place of business whether or not the facility is continuously used by a nonresident alien individual or foreign corporation.

(2) *Use of another person's office or other fixed place of business.* A nonresident alien individual or a foreign corporation shall not be considered to have an office or other fixed place of business merely because such alien individual or foreign corporation uses another person's office or other fixed place of business, whether or not the office or place of business of a related person, through which to transact a trade or business, if the trade or business activities of the alien individual or foreign corporation in that office or other fixed place of business are relatively sporadic or infrequent, taking into account the overall needs and conduct of that trade or business.

(c) *Management activity.* A foreign corporation shall not be considered to have an office or other fixed place of business merely because a person controlling that corporation has an office or other fixed place of business from which general supervision and control over the policies of the foreign corporation are exercised. The fact that top management decisions affecting the foreign corporation are made in a country shall not of itself mean that the foreign corporation has an office or other fixed place of business in that country. For example, a foreign sales corporation which is a wholly owned