DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

DATE: April 19, 2000

MEMORANDUM FOR BETTIE N. RICCA
ASSOCIATE DISTRICT COUNSEL
DELAWARE-MARYLAND DISTRICT, WASHINGTON, D.C.
CC:SER:DEM:WAS
Attention: Karen Chandler, Special Litigation Assistant

FROM: Jacob Feldman
Special Counsel, CC:INTL

SUBJECT:

This Field Service Advice responds to your memorandum dated November 8, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND

Corp A =

Corp A-FSC =

Corp B =

Country A =

Date 1 =

Date 2 =

Predecessor =

Product =

Purchaser =

Subsidiary 1 =

Tax Year 1 =
Tax Year 2 =
Tax Year 3 =

Year 1 =
Year 2 =
Year 3 =
Year 4 =

ISSUES

1. Whether income (including warranty and repair income) received by Corp A with respect to export sales of the Product to Purchaser under contracts acquired from Corp B, an unrelated entity, constitutes foreign trading gross receipts of Corp A within the meaning of I.R.C. § 924, where some sales of the Product had been shipped to the Purchaser by Corp B prior to Corp A's acquisition of the contracts.

2. Whether Corp A may use the administrative pricing rules of I.R.C. § 925(a) in determining commissions payable by Corp A to Corp A-FSC with respect to foreign trading gross receipts from export sales of the Product to the Purchaser.

CONCLUSIONS

1. Corp A's receipts with respect to the Product under contracts acquired from Corp B do not generate foreign trading gross receipts where Corp B shipped the Product prior to assignment of such contracts to Corp A. Temp. Treas. Reg. § 924(a)-1T(b). However, receipts with respect to sales in which the Product was shipped by Corp A after its acquisition of the contracts, including receipts from "related and subsidiary" services, may constitute foreign trading gross receipts, provided that Corp A is found to have met all other requirements of the FSC provisions, including performance of the foreign economic processes required under sections 924(d) and 924(e).

2. Corp A may use the administrative pricing rules of section 925(a) in determining commissions payable to Corp A-FSC with respect to any foreign trading gross receipts from sales of Product shipped to Purchaser by Corp A after acquiring the contracts from Corp B, but only if Corp A is found to have performed the activities required under section 925(c).

FACTS

Corp A, the taxpayer, is a domestic corporation. Corp A-FSC is a wholly-owned subsidiary of Corp A, incorporated in Country A on Date 1, and acts as a commission agent for Corp A's export sales. Subsidiary 1 is a wholly-owned domestic subsidiary of Corp A. For all tax years at issue, Corp A-FSC had in place a valid election to be treated as a foreign sales corporation (FSC) pursuant to sections 922(a)(2) and 927(f)(1) and in all other respects continuously maintained its status as a FSC as defined in section 922(a). Pursuant to service and commission agreements, Corp A and Subsidiary 1 undertake to perform on behalf of Corp A-FSC, and bill Corp A-FSC for, the foreign economic processes and activities required under sections 924(d) and 924(e) with respect to sales generating foreign trading gross receipts within the meaning of section 924(a). These agreements also obligate Corp A and Subsidiary 1, as related suppliers, to pay to Corp A-FSC the largest commission permitted for Federal income tax purposes.

The Product was originally developed and manufactured by Corp B, an unrelated domestic corporation. Between Years 1 and 3, Corp B entered into several contracts of sale with respect to the Product with Purchaser, an instrumentality of the United States government. Pursuant to these contracts, Corp B shipped the Product to the Purchaser between Years 2 and 4. On Date 2 (before the beginning of Year 4), Corp A[1] acquired from Corp B all contracts and other assets and liabilities related to the production of the Product. Subsequently, during Tax Years 1, 2 and 3, the Purchaser paid to Corp A portions of the contract price whose calculation had been deferred under Corp B's accounting method and the formulas set forth in the contracts. The Purchaser also paid Corp A for Product warranty and repair services that Corp A had assumed in the acquisition.

In its original income tax returns filed for Tax Years 1, 2 and 3, Corp A did not claim deductions for commissions payable to Corp A-FSC with respect to sales

[1] You have advised us that the taxpayer that made this acquisition and filed the original returns under audit was Predecessor, and that Corp A has succeeded to all of Predecessor's Federal tax attributes as the surviving entity in a subsequent corporate reorganization. All references to Corp A in this memorandum are to be understood as including both Corp A and Predecessor.

of the Product or related services. Subsequently, however, Corp A determined that the Purchaser used the Product outside the United States for the period of time required by Temp. Treas. Reg. § 1.927(a)-1T(d)(4)(iii). See Temp. Treas. Reg. § 1.924(a)-1T(g)(2). Pursuant to Temp. Treas. Reg. § 1.925(a)-1T(e)(4), Corp A now claims refunds of income taxes based on a redetermination of its commissions payable to Corp A-FSC for Tax Years 1, 2 and 3, based on adding the sales of the Product to those reported as eligible for FSC benefits. This claim is grounded on Corp A's position that the Product constitutes export property within the meaning of section 927(a) and that receipts from sale of the Product and related services constitute foreign trading gross receipts within the meaning of section 924(a). In computing commissions on the additional claimed foreign trading gross receipts, Corp A seeks to use the administrative pricing rules of section 925(a).

LAW AND ANALYSIS

I. Qualification as Foreign Trading Gross Receipts

The FSC provisions provide a partial exemption of income attributable to "foreign trading gross receipts." I.R.C. §§ 921(a), 923(a)(1), 923(b). Subject to the foreign economic processes requirements discussed below, foreign trading gross receipts generally include gross receipts received by a principal for whom a FSC acts as a commission agent from the sale, lease, exchange or other disposition of export property and for services related and subsidiary to such sale. I.R.C. §§ 924(a)(1), 924(a)(3)(A), 925(b)(1); Temp. Treas. Reg. § 1.924(a)-1T(a), (b).

Section 927(a) generally defines export property as property manufactured, produced, grown, or extracted in the United States; held primarily for sale or lease in the ordinary course of business by or to a FSC for direct use, consumption or disposition outside the United States; and not more than 50 percent of the fair market value of which is attributable to articles imported into the United States. Your submission is limited to certain issues regarding the definition of foreign trading gross receipts and does not raise any issue that may exist regarding the qualification of the Product as export property as defined in section 927(a). Solely for purposes of this advice, we assume that the Product is export property.

Under section 924(f)(1)(A)(ii), certain sales of export property to the United States government are excluded from status as foreign trading gross receipts. We understand that the applicability of this provision to Corp A's sales of the Product is at issue in this examination of the taxpayer but is not the subject of this advice. Solely for purposes of the discussion of the issues presented here, we assume that this exclusion does not apply.

A. Basic Definition -- Section 924(a)

1. Deferred Contract Income

The Temporary Treasury Regulations specifically address the situation of a contract of sale assigned to the taxpayer by a third party. Temp. Treas. Reg. § 1.924(a)-1T(b) provides, in pertinent part:

> Foreign trading gross receipts of a FSC include gross receipts from the sale of export property by the FSC, or by any principal for whom the FSC acts as a commission agent . . . pursuant to the terms of a contract entered into with a purchaser by the FSC or by the principal at any time or by any other person and assigned to the FSC or the principal at any time prior to the shipment of the property to the purchaser. . . . (Emphasis added)

This provision also appears, almost verbatim, in the Treasury Regulations under the Domestic International Sales Corporation (DISC) regime that preceded the FSC regime. See Treas. Reg. § 1.993-1(b). The Technical Memorandum released by the Service in connection with issuance of the DISC regulations stated that this shipment-date cut-off was carefully considered and adopted over commentator objections "because, without it, a DISC might be allocated income only as an afterthought after a transaction occurred." 1977 TM LEXIS 65 (T.D. 7514) (June 10, 1977).

Thus where, as here, a FSC or its principal receives income as an assignee of a contract of sale, those receipts potentially constitute foreign trading gross receipts only to the extent that the assignment occurs prior to shipment of the export property. With respect to most of the sale transactions involving the Product, Corp B's assignment of the contracts to Corp A on Date 2 occurred several years after shipment of the Product by Corp B to the Purchaser. Therefore, receipts of Corp A on account of the purchase price in such sales fail to meet the basic definition of foreign trading gross receipts as set forth in section 924(a). This basic definition is met, however, with respect to those sales of the Product shipped by Corp A to the Purchaser after Date 2. Receipts from the latter sales may constitute foreign trading gross receipts to the extent they meet all other requirements of the FSC provisions, including the foreign economic processes requirements at issue here and discussed below.

This conclusion is consistent with analysis of the nature of the property interest that Corp A acquired from Corp B. In the case of Product shipped before the assignment of the contracts on Date 2, the acquired property was, at most, accounts receivable whose amount remained subject to final calculation under the contract formula. Accounts receivable are not export property within the meaning of section 927(a)(1)(A) because they are not "manufactured, produced, grown, or extracted," and Corp A's later collection of such accounts receivable did not give

rise to foreign trading gross receipts because it was not a sale, exchange or other type of disposition of export property enumerated in section 924(a). The FSC regulations contain numerous references to disposition of receivables but in no context equate such disposition with sale of export property. See, e.g., Temp. Treas. Reg. § 1.924(a)-1T(g)(7) (discount on factoring of receivables from sale of export property reduces foreign trading gross receipts); Treas. Reg. § 1.924(e)-1(d)(2)(i) (proceeds of factoring qualify as receipt of payment for purposes of economic processes test); Treas. Reg. § 1.924(e)-1(e)(1)(iv) (factoring trade receivables qualify as assumption of credit risk in economic processes test); Treas. Reg. § 1.927(d)-1(a)(Q&A-4) (factoring payment treated as payment of sales proceeds for purpose of determining carrying-charge element of sales price, which is excluded from foreign trading gross receipts). See also Temp. Treas. Reg. § 1.927(b)-1T(b)(1) (loan proceeds excluded from definition of gross receipts).

With respect to sales shipped prior to Date 1, the date of incorporation of Corp A-FSC, an additional reason for failure of the income to qualify as foreign trading gross receipts arises under section 1.924(a)-1T(b), which provides, in pertinent part:

> Gross receipts from the sale of export property, whenever received, do not constitute foreign trading gross receipts unless the seller (or the corporation acting as commission agent for the seller) is a FSC at the time of the shipment of the property to the purchaser.

Since Corp A-FSC was not in existence at the time of shipments prior to Date 1, receipts with respect to these shipments, even to the extent received after Date 1, do not constitute foreign trading gross receipts.

2. Warranty and Repair Services

Gross receipts from services generally are not enumerated in section 924(a) and thus do not constitute foreign trading gross receipts. With respect to services relevant to this case, sections 924(a)(3) and 1.924(a)-1T(d)(2) provide that certain "related and subsidiary" services give rise to foreign trading gross receipts. Such services must be "furnished by the FSC"; "related" to a sale of export property giving rise to foreign trading gross receipts; and "subsidiary" to such sale.

a. "Furnished by the FSC"

Services are "furnished by the FSC" if they are provided by:

> (i) The person who sold . . . the export property to which the services are related and subsidiary, provided that the FSC acts as a commission agent with respect to the sale . . . of the property. . . ,

> (ii) The FSC as principal, or any other person pursuant to a contract with the FSC, provided the FSC acted as principal or commission agent with respect to the sale . . . of the property, or
>
> (iii) A member of the same controlled group as the FSC if the sale or lease of the export property is made by another member of the controlled group provided, however, that the FSC acts as principal or commission agent with respect to the sale . . . and as commission agent with respect to the services.

Temp. Treas. Reg. § 1.924(a)-1T(d)(2).

With respect to sales closed by shipment of the Product by Corp B to the Purchaser prior to Corp A's acquisition of the sale contracts, Corp A, the provider of the services, does not fall into any of the enumerated classes, being neither the seller of the export Product (to which the services are claimed to be related and subsidiary), nor a member of the same controlled group as the seller, nor under contract with Corp A-FSC to provide the services. Additionally, a condition stated in all enumerated classes has not been met in such cases because Corp A-FSC did not act as the principal or commission agent with respect to the sale of Product. If any FSC so acted, it was that of Corp B.

However, with respect to sales closed by shipment of the Product by Corp A to the Purchaser after Corp A's acquisition of the sale contracts, Corp A is described by at least the first category in Temp. Treas. Reg. § 1.924(a)-1T(d)(2), since Corp A was the seller of the Product and Corp A-FSC was the commission agent on the sale.

Accordingly, Corp A's services with respect to Product shipped prior to acquisition of the contracts were not "furnished by the FSC," while services with respect to post-acquisition shipments do pass this element. This result is consistent with that under the general rule governing assignments of contracts under section 1.924(a)-1T(b), discussed above. In both cases, shipment of the export property is recognized to be the key event determining the tax consequences of the transaction.

Because receipts for services with respect to pre-acquisition shipments fail an essential definitional element, they cannot constitute foreign trading gross receipts. Accordingly, we consider the remaining two elements with respect to post-acquisition shipments.

b. <u>"Related"</u>

Warranty and repair services are specifically listed as services potentially related to a sale of export property. Temp. Treas. Reg. § 1.924(a)-1T(d)(3). They are related if they are (1) customarily and usually furnished with the type of transaction in the trade or business in which the sale arose, and (2) provided for in the sale contract (expressly or by implied warranty) or in a separate arrangement offered to the purchaser prior to the first shipment of the goods and contracted for within two years after the sale contract. Id. Facts should be developed to determine whether Corp A meets the "related" element.

c. "Subsidiary"

Services related to a sale of export property are "subsidiary" to the sale if the gross receipts from all related services to be furnished in the first ten-year period following sale are reasonably expected at the time of sale not to exceed 50 percent of the total of the gross receipts from the sale and related services. Temp. Treas. Reg. § 1.924(a)-1T(d)(4). Facts should be developed to determine whether Corp A meets this element. The requisite reasonable expectation may be established through such evidence as estimates, budget proposals or cost projections made by Corp A contemporaneously with the sale of the Product.

d. Parts

If, as appears likely, parts are furnished in connection with the services at issue, the parts are disregarded in determining whether the services are "subsidiary." Receipts attributable to sale of the parts may qualify as foreign trading gross receipts independently of the rules governing services. Temp. Treas. Reg. § 1.924(a)-1T(d)(4)(v). Sales of parts should be analyzed under the rules discussed in I.A.1 above, relating to receipts on the sales of the Product. Specifically, the receipts from the sale of parts shipped prior to Date 2, the date of assignment of the contracts to Corp A, fail to meet the basic definition of foreign trading gross receipts under sections 924(a) and 1.924(a)-1T(b). By contrast, receipts from parts shipped after Date 2 may constitute foreign trading gross receipts to the extent they meet all other requirements of the FSC provisions, including the foreign economic processes requirements at issue here and discussed below.

In summary, the receipts from Corp A's warranty and repair services (including the sale of parts) with respect to pre-acquisition sales (again determined by date of shipment) fail to meet the basic definition of foreign trading gross receipts under section 924(a). However, with respect to post-acquisition sales, if the facts indicate that the services provided by Corp A are "related" and "subsidiary," receipts for such services may meet the basic definition and thus may constitute foreign trading gross receipts to the extent the sales meet all other

requirements of the FSC provisions, including the foreign economic processes requirements at issue here and discussed below.

B. Foreign Economic Processes -- Sections 924(b)(1)(B), 924(d) and 924(e)

Section 924(b)(1)(B) provides that "a FSC has foreign trading gross receipts from any transaction only if economic processes with respect to such transaction take place outside the United States as required by subsection (d)." (Emphasis added).

Section 924(d)(1)(A) requires the FSC "or any person acting under a contract with" the FSC to participate in the solicitation (other than advertising), negotiation or making of the sale contract. Treas. Reg. § 1.924(d)-1(c)(4) defines "making of a contract" as performance of any of the elements necessary to complete a sale, such as offer or acceptance. Making of a sale contract includes written confirmation by the FSC to the customer of an oral or written agreement which confirms variable contract terms, such as price, credit terms, quantity, or time or manner of delivery, or specifies (directly or by cross-reference) additional contract terms. Id.

Sections 924(d)(1)(B) and 924(d)(2) require the FSC to incur outside the United States certain minimum percentages of the direct costs attributable to activities enumerated in section 924(e). The activities set forth in section 924(e) are advertising and sales promotion; order processing and arrangements for delivery; transportation; determination and transmittal of final invoice or statement of account and receipt of payment; and assumption of credit risk. The FSC meets the percentage tests of sections 924(d)(1)(B) and 924(d)(2) if either its total foreign direct costs equal or exceed 50 percent of the total direct costs attributable to these activities with respect to the transaction, or if its foreign direct costs with respect to each of at least two of the enumerated activities equal or exceed 85 percent of the direct costs attributable to that activity. In meeting these percentage tests, the FSC is considered to perform activities performed by "any person acting under a contract with such FSC." I.R.C. § 924(d)(3)(A).

Under the authority of section 924(d)(4), the Treasury Regulations set forth rules implementing the foreign economic processes requirements in the case of commission FSCs. See, e.g., Treas. Reg. § 1.924(e)-1(c)(1) (transportation activity under section 924(e)(3) may be established if related supplier, rather than commission FSC, bears risk of loss during shipment); Treas. Reg. § 1.924(e)-1(e)(1) (credit risk assumption activity under section 924(e)(5) may be established if commission contract transfers costs of nonpayment from related supplier to commission FSC).

Section 927(d)(2)(B) provides generally that FSCs and their related suppliers may, to the extent provided in regulations, apply the FSC provisions on the basis of groups of transactions rather than on a transaction-by-transaction basis. The Treasury Regulations provide that in meeting the various foreign economic processes requirements, FSCs may elect to group transactions by product or product line (determined by either two-digit (or inferior) Standard Industrial Classification (SIC) code or by trade or industry usage), by customer, by contract, or by various combinations thereof. Treas. Reg. §§ 1.924(d)-1(c)(5), 1.924(d)-1(e). Groupings used for purposes of section 924(d)(1)(A) may be different from those used for the foreign direct cost tests under sections 924(d)(1)(B) and 924(d)(2), and grouping elections may be made separately for each of the activities within each test. Treas. Reg. §§ 1.924(d)-1(c)(5)(iii), 1.924(d)-1(e)(3). An activity performed with respect to any transaction in any such grouping is generally deemed performed with respect to all transactions in the grouping for the tax year. Treas. Reg. §§ 1.924(d)-1(c)(5), 1.924(d)-1(e). One exception is that where a product or product line grouping is used, required sales activities under section 924(d)(1)(A) must be performed with respect to either 20 percent or more of the foreign trading gross receipts in the group for the current tax year or 50 percent or more of the foreign trading gross receipts in the group for the preceding tax year. Treas. Reg. § 1.924(d)-1(c)(5)(i)(A). Similar 20-percent thresholds apply for the foreign direct cost tests under sections 924(d)(1)(B) and 924(d)(2) with respect to certain of the credit risk assumption activities under section 924(e)(5). Treas. Reg. § 1.924(e)-1(e)(4)(ii).

Treas. Reg. § 1.924(d)-1(b) provides that any person, related or unrelated, may perform any of the required activities, "provided that the activity is performed pursuant to a contract for the performance of that activity on behalf of the FSC." (Emphasis added). This rule recognizes services agreements such as those entered into among Corp A, Subsidiary 1, and Corp A-FSC. See also I.R.C. §§ 924(d)(1)(A), 924(d)(3)(A). Thus the plain language of the Code and Treasury Regulations contemplates that the foreign economic processes may be performed by or on behalf of the FSC.

With respect to sales of the Product shipped before Date 2, none of the requisite economic processes were, or could have been, performed by or on behalf of Corp A or Corp A-FSC. Neither Corp A nor Corp A-FSC had any interest in the Product or the contracts at issue at the time those sales were completed by shipment. The only taxpayer whose eligibility for FSC (or, for pre-FSC years, DISC) benefits in general, and whose performance of foreign economic processes in particular, could ever be at issue with respect to such sales is Corp B and its own FSC or DISC (if any). Nothing in the FSC regime permits an assignee such as Corp A to succeed to an assignor's performance of foreign economic processes as a tax attribute, to "tack" the assignor's activities onto its own, or to adopt a fiction

that the assignor's activities were somehow conducted "on behalf of" the assignee.

We note that this result is consistent with the rules governing services and assignment of contracts, discussed respectively at I.A.2 and I.A.1. above. Again the date of shipment determines whether alleged foreign trading gross receipts are appropriately attributable to a FSC and its related supplier.

With respect to sales of the Product shipped by Corp A after its acquisition of the contracts, Corp A's deferred contract income, as well as "related and subsidiary" warranty and repair income, may constitute foreign trading gross receipts provided that Corp A and Corp A-FSC met the requirements of section 924(d) with respect to the sale transactions or groups of transactions. Facts should be developed showing whether Corp A and Corp A-FSC met the standards prescribed under the Treasury Regulations for performance of these required foreign economic processes. For example, although Corp B appears to have solicited and negotiated the contracts, it is possible that Corp A participated in the making of the contracts by confirming open orders. See Treas. Reg. § 1.924(d)-1(c)(4). It also appears possible that Corp A and Corp A-FSC during the shipment process may have incurred at least 85 percent of two of the administrative activities enumerated in section 924(e) and thus may have met the test under section 924(d)(2). To the extent that the foreign economic processes cannot be documented as to each transaction at issue, Corp A-FSC may be able to use the broad grouping rules discussed above to have such processes deemed performed for all transactions in a group based on actual performance in only one or a limited number of transactions.

We note that the foreign economic processes requirements apply despite the procedural posture of this claim as a redetermination, by amended return, of commissions based on additional sales not originally reported as foreign trading gross receipts. These requirements would have applied had Corp A and Corp A-FSC treated these receipts as foreign trading gross receipts in their original returns. Even if the receipts at issue were not or could not have been identified at that time as foreign trading gross receipts, the taxpayer must demonstrate that the requisite foreign economic processes were performed by Corp A-FSC or its agent with respect to the transaction. Otherwise, Corp A and other taxpayers filing redetermination claims based on additional sales would be in a better position than taxpayers reporting the transactions on their original returns, an inequitable result. See Stokely-Van Camp, Inc. v. United States, 21 Cl. Ct. 731 (1990), aff'd on other grounds, 974 F.2d 1319 (Fed. Cir. 1992) (rejecting taxpayer argument that regulatory requirement to pay DISC commission contemporaneously with original sale transaction does not apply to additional sales on later amended return).

Similarly, we are aware that Treas. Reg. § 1.924(d)-1(f) exempts "foreign military sales" from the requirements of section 924(d)(1)(A). However, we do not

view sales to the United States government for use abroad as "foreign military sales" for this purpose.[2] We believe that the exemption merely recognizes that the solicitation, negotiation and other contracting activities normally performed by a seller are unnecessary where the United States government serves as an intermediary between a manufacturer and a foreign purchaser.

In summary, the foreign economic processes requirements are not met with respect to sales shipped prior to Date 2, but may be met, depending on the facts, with respect to sales shipped thereafter. To the extent such requirements as well as all other FSC requirements are met, Corp A's deferred contract income, as well as "related and subsidiary" warranty and repair income, constitutes foreign trading gross receipts.

II. Administrative Pricing Rules -- Section 925(c)

To the extent that the sales of the Product and "related and subsidiary" services generate additional foreign trading gross receipts to Corp A, Corp A claims that the administrative pricing methods allowed under section 925(a) are available to Corp A and Corp A-FSC.

Section 925(c) and Treas. Reg. § 1.925(a)-1T(b)(2)(ii) provide that the administrative pricing methods are available only if the sales activities listed in sections 924(d)(1)(A) and the direct cost activities listed in section 924(e) are performed by or on behalf of the FSC and the costs of such activities are reflected both on the FSC's books and in the computation of combined taxable income. However, the requisite activities are those in fact performed by any person with respect to the transaction; activities not applicable to the transaction are excluded from the section 925(c) requirements. Temp. Treas. Reg. § 1.925(a)-1T(b)(2)(ii). In cases where the related supplier is performing the required activities on behalf of the FSC, the requirements of section 925(c) are satisfied if (1) the FSC pays the related supplier an amount equal to the direct and indirect expenses with respect to those activities enumerated under sections 924(d)(1)(A) and 924(e) and actually performed, and (2) such costs are reflected on the FSC's books and taken into account in computing combined taxable income. Id. In lieu of the enumerated costs, the FSC may reflect all direct and indirect costs attributable to the transaction, other than cost of goods sold, as described in Temp. Treas. Reg. § 1.925(a)-1T(c)(6)(iii)(D). Id. If some of these costs are not paid or reflected on the FSC's books or in computing combined taxable income, the FSC may still use administrative pricing, with appropriate adjustments. Id.

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[2] This would not, however, affect any characterization of the Product as "military property" within the meaning of section 923(a)(5).

The activities referenced under section 925(c) are the economic processes discussed earlier as being required under sections 924(d) and 924(e) for gross receipts to be treated as foreign trading gross receipts. With respect to sales of the Product shipped before Date 2, we noted earlier that none of these activities were or could have been performed by Corp A or Corp A-FSC. Accordingly, the requirements of section 925(c) cannot be met with respect to such sales.

With respect to sales of the Product that were shipped by Corp A after its acquisition of the contracts and are determined under section I above to qualify as additional sales giving rise to foreign trading gross receipts, Examination should ascertain whether the expenses incurred by the taxpayer with respect to the sale and shipment were properly reflected on the FSC's books and were taken into account in computing combined taxable income.

In summary, Corp A and Corp A-FSC do not meet the requirements of section 925(c) with respect to sales shipped prior to Date 2, but may meet such requirements, depending on the facts, with respect to sales shipped thereafter. To the extent these requirements are met, commissions on foreign trading gross receipts arising from deferred contract income and "related and subsidiary" warranty and repair services may be computed using the administrative pricing rules of section 925(a).

If you have any further questions, please call either Jacob Feldman (202-622-3810) or Douglas Giblen (202-874-1490).

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JACOB FELDMAN
Field Service Special Counsel
Associate Chief Counsel (International)