



LB&I International Practice Service Concept Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Outbound	–	–
Volume	2	Deferral Planning	Level 1 UIL	9412
Part	2.2	Foreign Base Company Services Income	Level 2 UIL	9412.02
Chapter			Level 3 UIL	
Sub-Chapter				

Unit Name	Concepts of Foreign Base Company Services Income
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Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

[General Overview](#)

[Relevant Key Factors](#)

[Detailed Explanation of the Concept](#)

[Examples of the Concept](#)

[Training and Additional Resources](#)

[Glossary of Acronyms](#)

[Index of Related Issues](#)

General Overview

Overview of Foreign Base Company Services Income (FBCSvcl)

A U.S. shareholder of a foreign corporation is generally not subject to tax on the income of the corporation until the shareholder receives a distribution from the corporation. However, under subpart F, certain types of income earned by a controlled foreign corporation (CFC) are included in the income of the CFC's U.S. shareholders in the year earned, even if the CFC does not distribute the income to its shareholders in that year. One such type of income is Foreign Base Company Services Income (FBCSvcl). The rules for FBCSvcl are intended to deny deferral when a U.S. shareholder uses a CFC to inappropriately shift services income from the U.S. to foreign jurisdictions (or from a high-tax country to a low-tax country).

FBCSvcl is income (whether in the form of compensation, commissions, fees, or otherwise) derived by a CFC in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial or like services outside the CFC's country of organization for or on behalf of any related person (subject to certain exclusions). IRC 954(e), Treas. Reg. 1.954-4. A related person is an individual who controls the CFC or a corporation, partnership, trust or estate that controls or is controlled by the CFC (or the same person(s) that control the CFC). Treas. Reg. 1.954-1(f).

General Overview (cont'd)

Overview of Foreign Base Company Services Income (FBCSvcl)

Exceptions

FBCSvcl does not include income derived in connection with the performance of services that are directly related to (a) the sale or exchange by the CFC of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange; or (b) an offer or effort to sell or exchange such property. IRC 954(e)(2), Treas. Reg. 1.954-4(d).

Services income that falls within the definition of Foreign Base Company Oil Related Income is not FBCSvcl. IRC 954(b)(6). Additionally, FBCSvcl does not include certain services income derived in the active conduct of a banking, financing, securities, or insurance business. IRC 954(e)(2) (flush language). This last statement applies to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2015, unless it is extended by Congress. IRC 954(h)(9) and DPL/9412.03_02(2013). (Note: services related to oil and banking/related business are beyond the scope of this unit).

Relevant Key Factors

Overview of Foreign Base Company Services Income (FBCSvcl)

Key Factors

In determining whether to apply the FBCSvcl rules, three key factors must generally be addressed with respect to the CFC.

1. Whether the CFC derived income from the performance of services.
2. Whether the services were performed outside of the CFC's country of organization.
3. Whether the services were performed for, or on behalf of, a related person as defined in IRC 954(d)(3).

These factors can be determined by performing a functional analysis and reviewing relevant contracts.

Detailed Explanation of Concept

Overview of Foreign Base Company Services Income (FBCSvcl)

Key Factors

1. Whether the CFC derived income from the performance of services.

This factor is determined based on the substance of the transaction(s) without regard to the designation given to the income by the parties involved. Treas. Reg. 1.954-1(e)(1). A single transaction may give rise to income in more than one category of foreign base company income (FBCI). The income derived from the transaction should be separated and classified as to type of FBCI. In cases where income from a transaction is not separately determinable, the classification of the income should be made in accordance with the predominant character of the arrangement. Treas. Reg. 1.954-1(e)(2) and (3). FAA20153301F



CONSULTATION: The examiner should consult with counsel for assistance in reviewing contracts if the terms are unclear as to whether the activities/transactions are services; whether the related party was obligated to perform; and/or whether the performance of services constitutes a condition or material term of a sale.

Detailed Explanation of Concept (cont'd)

Overview of Foreign Base Company Services Income (FBCSvcl)

Key Factors

2. Whether the services were performed outside of the CFC's country of organization.

Generally, services are considered to be performed where the persons doing the work are physically located when they perform the activities that generate the services income. The determination will depend on the facts and circumstances of each case. Treas. Reg. 1.954-4(c).

FBCSvcl does not include income from services performed within the CFC's country of organization. However, in many cases, services are performed both within and outside the CFC's country of organization, so apportionment will be necessary to determine the income that is FBCSvcl versus the income that is not FBCSvcl. The total gross income of a CFC derived in connection with services performed for, or on behalf of, a related person must be apportioned on the basis of time spent by those employees of the CFC performing the services within and outside the CFC's country of organization. In allocating time spent within and outside the CFC's country of organization, relative weight must be given to the value of the various functions performed by persons in fulfillment of the services contract or arrangement. Treas. Reg. 1.954-4(c).

Note that while services may be performed in a branch of the CFC located outside the CFC's country of organization, the branch rules that apply for purposes of identifying Foreign Base Company Sales Income do not apply here. That is, the FBCSvcl rules do not contain rules that treat a CFC's branch as a wholly-owned subsidiary of the CFC. However, even though there are no branch rules for FBCSvcl, if there are CFC employees performing services in a branch outside of the CFC's country of organization, there is potential for FBCSvcl.

Detailed Explanation of Concept (cont'd)

Overview of Foreign Base Company Services Income (FBCSvcl)

Key Factors

3. Whether the services were performed for, or on behalf of, a related person as defined in IRC 954(d)(3).

Services are performed by a CFC for, or on behalf of, a related party when the CFC: (i) is paid or reimbursed by, is released from an obligation to, or otherwise receives substantial financial benefit from, a related person for performing the services; (ii) performs services that a related party is, or has been, obligated to perform; (iii) performs services with respect to property sold by the related party and the performance of such services constitutes a condition or material term of the sale; or (iv) receives substantial assistance furnished by a related person. Treas. Reg. 1.954-4(b)(1). For example, a CFC may generate FBCSvcl if it derives income for performing services outside its country of organization directly for a related party. Assume United States Parent (USP) signed a contract to perform a service for an unrelated party; USP assigned the contract to its wholly-owned CFC; and USP was completely released from any obligation under the contract. If the CFC performed those services outside its country of organization, the income from those services would be FBCSvcl. Treas. Reg. 1.954-4(b)(3) Example 5.

Detailed Explanation of Concept (cont'd)

Overview of Foreign Base Company Services Income (FBCSvcl)

Key Factors

3. Whether the services were performed for, or on behalf of, a related person as defined in IRC 954(d)(3).

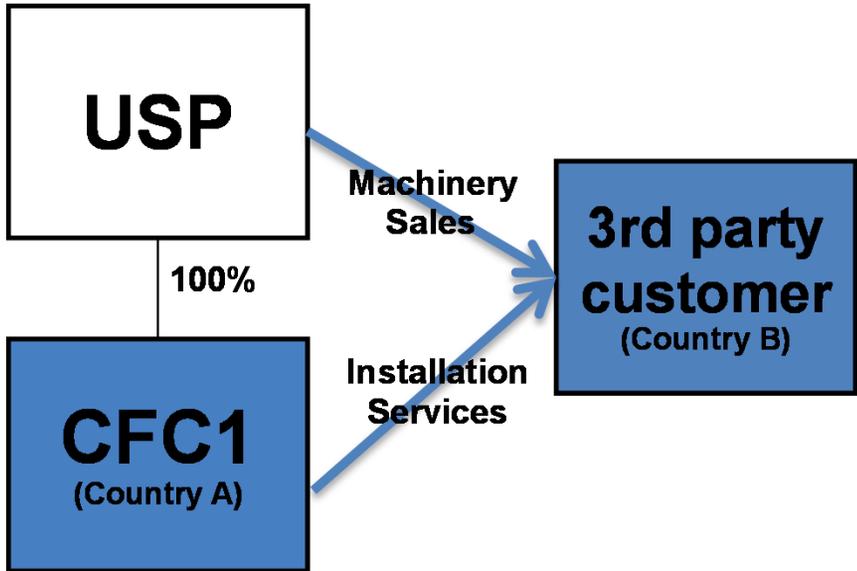
A CFC may generate FBCSvcl if it receives substantial assistance from a related person in performing services. The substantial assistance regulations seek to prevent the artificial shifting of service income from the related person to a CFC established in a low-tax jurisdiction merely by using the CFC as a conduit for the delivery of the related person's services to clients who paid for those services. The scope of the substantial assistance regulations (Treas. Reg. 1.954-4(b)(1)(iv) and (b)(2)(ii)) has been significantly limited by Notice 2007-13, applicable to tax years of foreign corporations beginning on or after January 1, 2007. In particular, the Notice limited the substantial assistance rules to situations involving a related United States person (IRC 957(c)) and narrowed the scope of what constitutes substantial assistance. Assistance includes, but is not limited to, direction, supervision, services, know-how, financial assistance (other than contributions to capital), and equipment, material, or supplies provided directly or indirectly by a related United States person to a CFC. The assistance will be considered substantial if it satisfies an objective cost test (which was also revised under the Notice).

Under Notice 2007-13, the cost test will be satisfied if the cost to the CFC of the services furnished by the related United States person(s) equals or exceeds 80 percent of the total cost to the CFC of performing the services. The term "cost" will be determined after taking into account adjustments, if any, made under IRC 482 (i.e. using an arm's length standard).

Examples of the Concept

Overview of Foreign Base Company Services Income (FBCSvcl)

Example 1



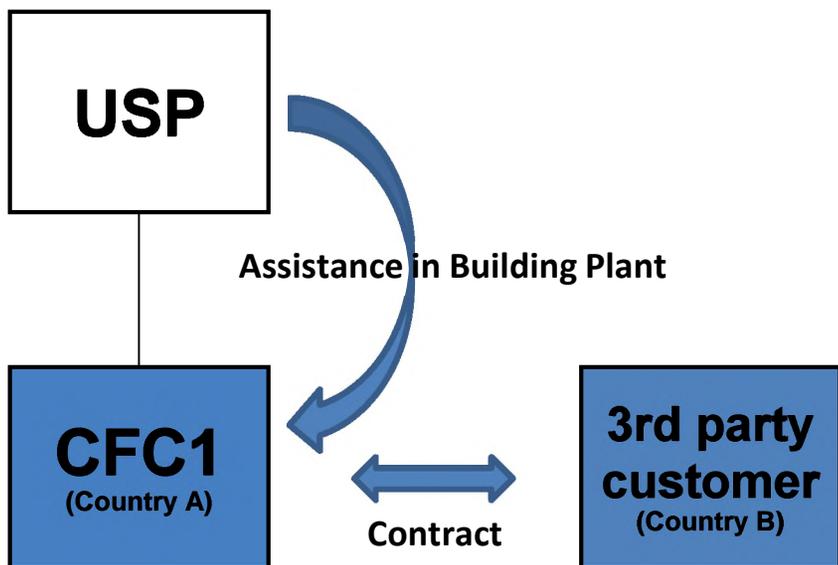
USP, a domestic corporation, is the 100% owner of CFC1, incorporated in Country A. USP manufactures and sells machinery to a third-party customer in Country B. USP has CFC1 perform the necessary installation services with respect to the machinery.

USP pays CFC1 for performing the necessary installation services. The installation services by CFC1 are performed outside CFC1's country of organization for, or on behalf of, a related party, USP. As a result, CFC1 generates FBCSvcl, and USP may have a "subpart F inclusion" under IRC 951. Treas. Reg. 1.954-4(b)(3) Example 1.

Examples of the Concept (cont'd)

Overview of Foreign Base Company Services Income (FBCSvcl)

Example 2



CFC1, incorporated in Country A, enters into a contract with an unrelated person in Country B to build a factory. The domestic parent of CFC1, USP, provides direction, supervision, services, know-how, financial assistance (other than capital), equipment, material, and supplies to CFC1. USP's assistance equals 80% of the total costs of the plant building project.

Because the arm's-length cost to the CFC of USP's assistance equals 80% of the total cost, USP has provided substantial assistance with respect to the services performed outside CFC1's country of organization. Therefore, CFC1 has generated FBCSvcl, and USP may have a subpart F inclusion. Notice 2007-13.

Training and Additional Resources

Overview of Foreign Base Company Services Income (FBCSvcl)		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ Training - FY 2011 CPE "Live" Recordings ▪ PPT including slides on FBCSvcl 	<ul style="list-style-type: none"> ▪ Discussion of FBCSvcl is included in the resources at left.
Issue Toolkits		
White Papers / Guidance	<ul style="list-style-type: none"> ▪ Westlaw subscription 	<ul style="list-style-type: none"> ▪ Bittker & Lokken 69.6 ▪ TMFEDPORT No. 928-3rd VIII. Foreign Base Company Services Income ▪ Notice 2007-13 ▪ FAA20153301F
Podcasts / Videos		
Articles		
Bloomberg BNA		

Glossary of Acronyms

Acronym	Definition
CFC	Controlled Foreign Corporation
FAA	Field Attorney Advice
FBCSvcl	Foreign Base Company Services Income
USP	US Parent

Index of Related Issues

Issue	Associated UIL(s)	References
▪ Subpart F Overview	▪ 9412	▪ Subpart F Overview, DPL/CU/V_2_01(2013); Overview of Subpart F Income for U.S. Individual Shareholders, FEN/9433.01_09(2013)
▪ Foreign Base Company Income	▪ 9412.05	▪ Computing Foreign Base Company Income, DPL/9412.05_05(2013)
▪ Outbound Services	▪ 9411.07	▪ Outbound Services by U.S. Companies to CFCs, ISO/9411.07_02(2013)