Number: **200131012**
Release Date: 8/3/2001
CC:INTL:6
TL-N-3372-99
UILC: 924.01-00
927.01-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

DATE: April 30, 2001

MEMORANDUM FOR LMSB Division Counsel, Area 5
Attn: Ronald M. Rosen
Attorney, CC:LM:CTN:1

FROM: Elizabeth Beck
Senior Technical Reviewer CC:INTL:6

SUBJECT: FSC Commissions derived from Sublicenses

This Chief Counsel Advice responds to your memorandum dated October 6, 2000. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Entities

CorpA =
CorpA-FSC =
Tax Exempt Entity =
CFPartnership1 =
CFPartnership2 =
CFPartnership3 =
USPartnership =
SCorpA =
SubA =

Jurisdictions

U.S. State1 =
U.S. State2 =
Country1 =
Country2 =
Country3 =

Country4 =

Percentage Amounts

AmountA =
AmountB =
AmountC =
AmountD =
AmountE =
AmountF =
AmountG =
AmountH =
AmountI =
AmountJ =

Miscellaneous

Individual =
Taxable Year 1 =
Taxable Year 2 =

ISSUES

1. Whether the gross receipts from sublicenses of computer software to unrelated foreign end-users by controlled foreign partnerships that licensed the computer software from their domestic parent corporation that manufactured the computer software in the United States and shipped the computer software directly to the foreign end-users outside the United States are disqualified from the status of foreign trading gross receipts under section 924.

2. If the gross receipts constitute foreign trading gross receipts under section 924, whether the controlled foreign partnerships are "related suppliers" and, thus, not disqualified from computing a commission payable to CorpA-FSC under section 925(a)(2), provided that all other foreign sales corporation requirements are met under sections 921 through 927.

CONCLUSIONS

1. No. The fact that the gross receipts are from sublicenses of computer software to unrelated foreign end-users by controlled foreign partnerships that licensed the computer software from their domestic parent corporation that manufactured the computer software in the United States and shipped the computer software directly to the foreign end-users outside the United States does not, in itself, disqualify such receipts from the status of foreign trading gross receipts under section 924.

2. Yes. Because the controlled foreign partnerships were related suppliers to CorpA-FSC with respect to the sublicensed computer software, they are not disqualified from computing a commission payable to CorpA-FSC under section 925(a)(2), provided

that all other foreign sales corporation requirements are met under sections 921 through 927.

FACTS

I. The Parties and Transactions Generally

CorpA is a subchapter C corporation organized in U.S. State1 and wholly-owned by Individual, a United States citizen. CorpA-FSC is a wholly-owned subsidiary of CorpA, incorporated in Country1. For Taxable Years 1 and 2, CorpA-FSC had in place a valid election to be treated as a foreign sales corporation ("FSC") pursuant to sections 922(a) and 927(f)(1) and in all other respects continuously maintained its status as a FSC as defined in section 922(a).

At all relevant times, CorpA developed and manufactured (within the meaning of section 927(a)(1)(A)) computer software ("Product") within the United States and, as discussed below, exported some of Product abroad with CorpA-FSC acting as its commission agent. For purposes of this advice, we assume that Product satisfied the foreign content test of section 927(a)(1)(C) and Temp. Treas. Reg. § 1.927(a)-1T(e) for FSC export property. We further assume that CorpA-FSC satisfied the foreign management requirements of sections 924(b)(1)(A) and 924(c) and the foreign economic process requirements of sections 924(b)(1)(B) and 924(d) with respect to the transactions in question.[1]

With respect to Products exported, CorpA licenses Product to entities located in foreign countries that sublicense Product to foreign end-users. The foreign end-users are companies unrelated to CorpA that use Product in their business operations outside the United States. During Taxable Years 1 and 2, CorpA licensed Product to four different kinds of entities located in foreign countries: unrelated third parties, Corp A's controlled foreign corporations, CorpA's branch offices, and foreign corporations treated by CorpA as partnerships ("controlled foreign partnerships") for United States tax purposes. Except in the case of the branch offices, the licensees paid CorpA a portion of the amount that the sublicensees paid to the licensees. For example, when a licensee sublicensed Product to a foreign end-user, the licensee would pay CorpA a portion of its sublicensing fee and keep the remainder of the fee. CorpA employs the same payment system whether the licensee is related or unrelated. For the purposes of this advice, we assume that the amount charged by CorpA meets the arm's length standard requirement under Temp. Treas. Reg. § 1.925(a)-1T(e)(2).

The issues here pertain to the sublicenses of Product by the controlled foreign partnerships located in Countries2, 3, and 4. In this regard, facts concerning the ownership of the controlled foreign partnerships and the particulars of the licensing

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[1] Further development of the facts regarding the requirements under section 924(b)(1) may be appropriate to determine whether the FSC provisions apply, as a threshold matter, to the controlled foreign partnerships' gross receipts from sublicenses of Product.

agreements are essential.[2]

II. Controlled Foreign Partnerships

The three controlled foreign partnerships in question were owned as follows:

1) CFPartnership1 was owned AmountA% by Individual, AmountB% by CorpA, and AmountC% by Tax Exempt Entity;

2) CFPartnership2 was owned AmountA% by Individual, AmountB% by CorpA, and AmountC% by Tax Exempt Entity;

3) At the beginning of Taxable Year 1, CFPartnership3 was owned AmountD% by SCorpA (an S corporation), AmountE% by SubA (a C corporation), AmountF% by CorpA, and AmountC% by Tax Exempt Entity. SCorpA and SubA were wholly-owned by Individual and organized under the laws of U.S. State1. During Taxable Year 1, ScorpA contributed a AmountG% partnership interest in CFPartnership3 to USPartnership, a limited liability company organized in U.S. State2 and owned predominantly by CorpA. In Taxable Year 2, SCorpA contributed its remaining AmountH% partnership interest in CFPartnership3 to USPartnership. At all times relevant to this case, CorpA owned AmountI% of USPartnership, and SCorpA owned the other AmountJ% of USPartnership.

CFPartnership1 was formed and operates in Country2; CFPartnership2 was formed and operates in Country3; and, CFPartnership3 was formed and operates in Country4.

III. Licensing Agreements

Generally, CorpA licensed Product directly to the controlled foreign partnerships which, in turn, sublicensed Product directly to foreign end-users.[3] The licensing agreements granted the controlled foreign partnerships a limited, non-transferable, non-exclusive right to sublicense Product to foreign end-users within a specified territory. The sublicensing agreements granted the foreign end-users a limited right to use Product in their businesses. Neither the licenses nor the sublicenses conferred title, ownership, or intellectual property rights in Product to the licensees or sublicensees. We assume that, for tax purposes and under sections 921 through 927 ("the FSC provisions") in particular, the licenses and sublicenses of Product in question were

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[2] This field service advice expresses no opinion regarding the validity of the controlled foreign partnerships or their partnership allocations. For purposes of this advice, the controlled foreign partnerships and their partnership allocations are treated as valid.

[3] In the case of CFPartnership3, CorpA licensed Product through USPartnership, which it controlled. For purposes of this field service advice and for simplicity, CorpA is treated as dealing directly with CFPartnership3.

leases and subleases of property, i.e., of a copyrighted article as that term is used under Temp. Treas. Reg. § 1.927(a)-1T(f)(3). We assume further that the terms of the licenses and sublicenses were for a comparable period with comparable terms of payment within the meaning of Temp. Treas. Reg. § 1.925(a)-1T(b)(2)(iii)(B).[4]

The controlled foreign partnerships were obligated under the licensing agreements to secure a "Customer Agreement" from each sublicensee, submit orders for Product to CorpA, and pay fees to CorpA for rights granted and services provided by CorpA. The controlled foreign partnerships also were responsible for installing, supervising, managing, and controlling the use of Product. Each of the controlled foreign partnerships is staffed by employees from the country in which it is located.

In return, CorpA used its best efforts to deliver ordered Product to the sublicensees. CorpA used a commercial freight company to ship Product directly from the United States to foreign end-users in Countries2, 3, and 4 in response to orders placed by the controlled foreign partnerships. The licensing agreements referred to the foreign end-users as the "licensee's customers."

IV. Use of Commission FSC

As stated above, during Taxable Years 1 and 2, CorpA-FSC acted as a commission agent (as defined under section 925(b)(1) and Temp. Treas. Reg. § 1.925(a)-1T(d)(2)) with respect to the licensing transactions between CorpA and the controlled foreign partnerships. With respect to each item of Product, CorpA-FSC claimed a commission on the payment from the controlled foreign partnerships to CorpA and a separate commission on the payment from the foreign end-users to the controlled foreign partnerships. Examination does not challenge CorpA's application of the FSC provisions to determine CorpA-FSC's commission based on the gross receipts generated by such licenses of Product.

For Taxable Years 1 and 2, CorpA claims that CorpA-FSC acted as the controlled foreign partnerships' commission agent with respect to Product sublicensing transactions between the controlled foreign partnerships and the foreign end-users. CorpA asserts that such sublicensing transactions gave rise to foreign trading gross receipts upon which CorpA-FSC earned a commission. CorpA-FSC computed its commissions using the combined taxable income ("CTI") method under section 925(a)(2) for all licensing and sublicensing transactions at issue in this case. In computing the commission attributable to the payment from the foreign end-users, the

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[4] Because the licenses and sublicenses are treated as leases and subleases of a copyrighted article under the FSC provisions, Product is not excluded as export property under section 927(a)(2)(B) and Temp. Treas. Reg. § 1.927(a)-1T(f)(3). Cf. Treas. Reg. § 1.861-18(c)(2) (providing – for purposes of, inter alia, the FSC provisions and for transactions that occur pursuant to contracts entered into on or after December 1, 1998, – that a transfer of a copyrighted article is categorized as a lease (rather than a sale or exchange) if insufficient benefits and burdens of ownership of the copyrighted article are transferred such that a person other than the transferee is properly treated as the owner of the copyrighted article).

controlled foreign partnerships and CorpA-FSC deducted the payment to CorpA for the license of Product.

The examination team challenges CorpA's claims relating to the sublicenses of Product on two independent grounds. First, Examination argues that the sublicensing transactions do not generate foreign trading gross receipts because Product does not constitute export property under the destination test of Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i). Second, the examination team argues that, even if the sublicenses of product generate foreign trading gross receipts, CorpA-FSC could not earn commissions with respect to such receipts because, under the FSC provisions, a single FSC cannot have more than one related supplier with respect to multiple transactions involving a single item of export property such as the licenses and sublicenses in this case.

LAW AND ANALYSIS

I. Overview of Law

Section 921 provides that the exempt foreign trade income of a FSC shall be treated as foreign source income which is not effectively connected with the conduct of a trade or business within the United States and, thus, excluded from the gross income of the FSC. Section 923(a)(1) defines exempt foreign trade income as the aggregate amount of all foreign trade income of a FSC for the taxable year that is described in section 923(a)(2) or (3). Sections 923(a)(2) and (3) provide that such amount is a certain percentage of foreign trade income derived from a transaction to which section 925(a) or (b) applies.

Section 923(b) defines foreign trade income for purposes of the FSC provisions to mean the gross income of a FSC attributable to foreign trading gross receipts ("FTGR"). Section 924(a)(2) provides that FTGR include the gross receipts of any FSC that are from the lease or rental of export property for use by the lessee outside the United States. Further, under section 924(a)(3)(B) FTGR include gross receipts for services that are related and subsidiary to the lease or rental of export property described in section 924(a)(2).[5] Temp. Treas. Reg. § 1.924(a)-1T(a)(2) provides that, for purposes of determining FTGR, the rules of that regulation applicable to leases of

[5] The controlled foreign partnerships performed certain services, such as installation, maintenance, repair, warranty services and marketing, some of which may constitute related and subsidiary services under the criteria provided in Temp. Treas. Reg. § 1.924(a)-1T(d). To the extent that such services do not come within the scope of section 924(a)(3)(B) or exceed the 50% gross receipts test under Temp. Treas. Reg. § 1.924(a)-1T(d)(4), gross receipts from the sublicenses of Product attributable to such disqualified services do not constitute FTGR. Because we have insufficient information to determine whether the controlled foreign partnerships provided qualifying related and subsidiary services under section 924(a)(3)(B) and the regulations thereunder, for purposes of addressing the issues at hand, we have assumed that all gross receipts from the sublicenses of Product fall within the category of activities that may constitute FTGR under section 924(a)(2), provided all other FSC requirements are met.

export property apply in the same manner to subleases.

A FSC that applies the FSC provisions to a sublicensing transaction under section 924(a)(2) must also satisfy the foreign management requirements of sections 924(b)(1)(A) and 924(c) and the foreign economic process requirements of sections 924(b)(1)(B) and 924(d). If a FSC does not satisfy such requirements, the FSC will be treated as having no FTGR. A taxpayer's leasing or subleasing activities, in combination with its satisfaction of the requirements under section 924(b)(1), can qualify the taxpayer for FSC treatment.

Export property is defined under section 927(a)(1) which contains three criteria. First, the property must be manufactured, produced, grown, or extracted in the United States by a person other than a FSC. I.R.C. § 927(a)(1)(A). The fact that a taxpayer subleases property that it did not manufacture or produce itself does not prevent the application of the FSC provisions to gross receipts from such sublease. Second, the property must satisfy a foreign content test under section 927(a)(1)(C). See also Temp. Treas. Reg. § 1.927(a)-1T(e). Third, the property must be held primarily for sale, lease, or rental in the ordinary course of trade or business by, or to, a FSC for direct use, consumption, or disposition outside the United States. I.R.C. § 927(a)(1)(B). Temp. Treas. Reg. § 1.927-1T(d)(1) provides that property is sold or leased for direct use, consumption, or disposition outside the United States if the sale or lease satisfies the destination test described in subdivision (2) of paragraph (d) of such regulation and also meets two other requirements not at issue here. Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i) provides that the destination test is satisfied only if the property is delivered by the seller or lessor (or an agent of the seller or lessor) by any of six alternative methods. Under Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i)(A), the destination test is satisfied if the property is delivered within the United States to a freight forwarder for ultimate delivery outside the United States to the purchaser or lessee (or to a subsequent purchaser or sublessee). However, even if a taxpayer satisfies the requirements of Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i), the destination test is not satisfied if the property is subjected

> to any use (other than a resale or sublease), manufacture, assembly, or other processing (other than packaging) by any person between the time of the sale or lease by the seller or lessor and the delivery or ultimate delivery outside the United States.

Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii).

Section 925(a) provides that, in the case of a sale of export property to a FSC by a person described in section 482 (a "related supplier"), the taxable income of the FSC and the person shall be based upon a transfer price that would allow the FSC to derive taxable income attributable to such sale (regardless of the sales price actually charged) in an amount that does not exceed the greatest of three enumerated pricing methods. One of the enumerated pricing methods under section 925(a)(2) is the CTI method. Under the CTI method, the FSC's taxable income may not exceed 23% of the CTI (of the FSC and the related supplier) that is attributable to the FTGR derived from the sale of export property by the FSC. Temp. Treas. Reg. § 1.925(a)-1T(c) provides rules for computing the allowable price for a transfer from a related supplier to a FSC in the case

of a sale.

Section 925(b) provides that the Secretary shall prescribe regulations setting forth rules that are consistent with the rules set forth in section 925(a) for the application of section 925 in the case of commissions, rentals, and other income. Temp. Treas. Reg. § 1.925(a)-1T(a)(2) provides that the rules relating to the determination of the transfer price under Temp. Treas. Reg. § 1.925(a)-1T(c) are directly applicable only in the case of sales or exchanges of export property to a FSC for resale and are applicable by analogy to leases, commissions, and services as provided in Temp. Treas. Reg. § 1.925(a)-1T(d). Temp. Treas. Reg. § 1.925(a)-1T(d)(1) provides that, in the case of a lease of export property by a related supplier to a FSC for sublease by the FSC, the amount of rent shall be computed in a manner consistent with the rules for computing transfer prices for sales and resales. Further, Temp. Treas. Reg. § 1.925(a)-1T(d)(2) provides that,

> [i]f any transaction to which section 925 applies is handled on a commission basis for a related supplier by a FSC and if commissions paid to the FSC give rise to gross receipts to the related supplier which would have been foreign trading gross receipts under section 924(a) had the FSC made the sale directly, then the administrative pricing methods of section 925(a)(1) or (2) may be used, to determine the FSC's commission . . . ."[6]

Because commissions are determined with respect to FTGR as defined in Temp. Treas. Reg. § 1.924(a)-1T, a sublease is treated as a lease for purposes of applying the related supplier requirement for CTI method FSC commissions under Temp. Treas. Reg. § 1.925(a)-1T(c). Temp. Treas. Reg. §§ 1.925(a)-1T(b)(1) and 1.924(a)-1T(a)(2). The adminsitrative pricing methods (including the CTI method) may be applied to a leasing transaction between a related supplier and a FSC (provided the required performance activities have been met) only if the

> related supplier leases export property to the FSC for sublease for a comparable time period with comparable terms of payment, or the FSC acts as commission agent for the related supplier on leases of export property by the related supplier, to third parties whether or not related.

Temp. Treas. Reg. § 1.925(a)-1T(b)(2)(iii)(B).

In order to use the CTI method to calculate the amount of a FSC commission, the commission must be paid or payable by a related supplier. Temp. Treas. Reg. § 1.925(a)-1T(d)(2); see also Temp. Treas. Reg. § 1.923-1T(a). Temp. Treas. Reg. § 1.927(d)-2T(a) defines the term "related supplier" and states as follows:

> For the purposes of section 921 through 927 and the regulations under those sections, the term "related supplier" means a related party which

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[6] Temp. Treas. Reg. § 1.925(a)-1T(d)(2) contains an additional requirement that certain economic activities described under section 925(c) must be performed in order for a FSC to earn a commission.

> directly supplies to a FSC any property or services which the FSC disposes of in a transaction producing foreign trading gross receipts, or a related party which uses the FSC as a commission agent in the disposition of any property or services producing foreign trading gross receipts. A FSC may have different related suppliers with respect to different transactions. If, for example, X owns all the stock of Y, a corporation, and of F, a FSC, and X sells a product to Y which is resold to F, only Y is the related supplier of F. If, however, X sells directly to F and Y also sells directly to F, then, as to the transactions involving direct sales to F, each of X and Y is a related suppler of F.

Section 927(d)(2)(ii) defines a "transaction" to include, inter alia, any lease or rental. Temp. Treas. Reg. § 1.927(d)-2T(b) defines "related party" to mean "a person that is owned or controlled directly or indirectly by the same interests as the FSC within the meaning of Treas. Reg. § 1.482-1(a)." For purposes of Treas. Reg. § 1.482-1, Treas. Reg. § 1.482-1(i)(4) defines the term "controlled" broadly to include "any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised . . . ." The reality of control, rather than the form of control or the mode of its exercise, is the decisive factor. Treas. Reg. § 1.482-1(i)(4).

II. Analysis

For purposes of this advice, the examination team and the taxpayer agree that Product meets two, i.e., section 927(a)(1)(A) and (C), of the three statutory criteria for qualification as export property. The parties disagree on whether Product was held primarily for sublicense by a related supplier using a commission FSC for direct use, consumption, or disposition outside the United States under sections 927(a)(1)(B) and 925(b)(1). More specifically, the parties disagree as to whether Product met the destination test under Temp. Treas. Reg. §§ 1.927(a)-1T(d)(1) and (2) and whether the controlled foreign partnerships were "related suppliers" under Temp. Treas. Reg. §§ 1.925(a)-1T(d)(2) and 1.927(d)-2T.

A. The Destination Test

Under Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i)(A), the destination test is satisfied if the property is delivered within the United States to a freight forwarder for ultimate delivery outside the United States to the purchaser or lessee (or to a subsequent purchaser or sublessee). For example, if a domestic manufacturer leases its goods to a person that, in turn, subleases those goods to an unrelated third party, the manufacturer/lessor can satisfy the destination test by shipping the goods by common carrier directly to the sublessee. Similarly, the lessee satisfies the destination test if the manufacturer ships the goods by common carrier directly to the sublessee. In short, a single delivery event can satisfy the destination test with respect to two different taxpayers. A taxpayer need not establish physical possession of the property with respect to which the taxpayer applies the FSC provisions. However, even if the criteria under Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i) are met, the destination test is not satisfied with respect to property that

> is subject to any use (other than a resale or sublease), manufacture,

assembly, or other processing (other than repackaging) by any person between the time of the sale or lease by such seller or lessor and the delivery or ultimate delivery outside the United States . . . ."

Treas. Reg. § 1.927(a)-1T(d)(2)(iii).

In this case, CorpA, the licensor, as agent for the controlled foreign partnerships, delivered Product within the United States to a freight forwarder. The freight forwarder was instructed to deliver Product to the foreign end-users located outside the United States. The freight forwarder delivered Product to the foreign end-users in foreign countries. The foreign end-users were sublessees of CorpA's Product which underwent no use (other than sublease), manufacture, assembly, or other processing between the time of the sublease and the ultimate delivery outside the United States. Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(iii) does not prevent Product from satisfying the destination test. Therefore, the fact that the gross receipts are from subleases of Product to unrelated foreign end-users by controlled foreign partnerships that leased Product from their domestic parent corporation that manufactured product in the United States and shipped Product directly to the foreign end-users outside the United States does not, in itself, disqualify such receipts from the status of FTGR under section 924.

B. Related Supplier Requirement

In order to use the CTI method to calculate the amount of a FSC commission, the commission must be paid or payable by a related supplier. Temp. Treas. Reg. §§ 1.925(a)-1T(d)(2) and 1.923-1T(a). As relevant here, Temp. Treas. Reg. § 1.927(d)-2T(a) defines the term "related supplier" as a related party that uses the FSC as a commission agent in the disposition of any property or services producing FTGR.

Assuming that CorpA-FSC was under contract as a commission agent for each of the controlled foreign partnerships at the time of the sublicensing transactions, and assuming that the gross receipts from such transactions constitute FTGR, the issue is whether the controlled foreign partnerships were related parties to CorpA-FSC with respect to such transactions. Based on the following analysis, we conclude that the controlled foreign partnerships were related parties to CorpA-FSC during Taxable Years 1 and 2 with respect to the sublicenses of Product.

During Taxable Years 1 and 2, Individual owned AmountA% of CFPartnership1 directly and owned another AmountB% of CFPartnership1 indirectly through Individual's ownership of CorpA. Therefore, Individual controlled, directly or indirectly, a majority interest in CFPartnership1. In the same manner, Individual controlled, directly or indirectly, a majority interest in CFPartnership2 during Taxable Years 1 and 2. During Taxable Years 1 and 2, Individual wholly-owned CorpA, SCorpA, and SubA. At the same time, these three corporations owned directly, or indirectly through USPartnership, a majority interest in CFPartnership3. Thus, Individual indirectly controlled a majority interest in CFPartnership3 during Taxable Years 1 and 2. At the same time, Individual controlled CorpA-FSC indirectly through Individual's ownership of CorpA which, in turn, owned CorpA-FSC.

Individual's direct and indirect ownership and control of the three controlled foreign partnerships and CorpA-FSC during Taxable Years 1 and 2 satisfied the control requirement for a related party under Temp. Treas. Reg. § 1.927(d)-2T(b) and Treas. Reg. § 1.482-1(i)(4). Therefore, the controlled foreign partnerships and CorpA-FSC were related parties during Taxable Years 1 and 2.

The examination team further argues that a FSC may have only one related supplier with respect to a single item of export property and that a single FSC may not take part in multiple transactions that involve the same export property. We disagree. Temp. Treas. Reg. § 1.927(d)-2T(a) provides that a FSC may have more than one related supplier with respect to different transactions. Section 927(d)(2)(ii) defines "transaction" to include any lease or rental. Temp. Treas. Reg. § 1.924(a)-1T(a)(2) defines "lease" to include any sublease. Here there are two transactions, a lease and a sublease, that involve different parties and contractual rights. Therefore, both the leases and the subleases of Product in this case qualify as transactions under Temp. Treas. Reg. § 1.927(d)-2T(a).

Further, Temp. Treas. Reg. § 1.927(d)-2T(a) provides the following example: "If . . . X sells directly to F [a FSC] and Y [a corporation] also sells directly to F, then, as to the transactions involving direct sales to F, each of X and Y is a related supplier." This example demonstrates that a FSC can have more than one related supplier with respect to more than one transaction that involve different items of property. The example does not, however, preclude the possibility that a FSC can have different related suppliers with respect to different transactions that involve the same property. In fact, the language of provisions such as Temp. Treas. Reg. § 1.927(a)-1T(d)(2)(i)(A) – which provides that delivery of a product to a sublessee may satisfy the destination test – anticipates such situations. A logical corollary to the notion that a FSC can have two related suppliers with respect to two transactions that involve the same property is that a FSC may earn a commission on two different transactions that involve the same property.

In this case, Product is the object of two separate transactions, that is, a lease and a sublease. CorpA-FSC, like all FSCs, may have different related suppliers with respect to multiple transactions under Temp. Treas. Reg. § 1.927(d)-2T(a).

In addition, Temp. Treas. Reg. § 1.925(a)-1T(e)(2) requires related lessees to pay an arm's length price. This arm's length standard requirement, in combination with the CTI method, helps to ensure that the use of multiple transactions – as opposed to a single transaction – to convey domestically manufactured products from the United States for use outside the United States does not result in an improper increase in FSC exemptions.[7] We also note that, if CorpA had leased Product directly to the unrelated foreign end-users with CorpA-FSC acting as a commission agent, the overall FSC exemption claimed by CorpA-FSC in that case would have been identical to the overall FSC exemption claimed by CorpA-FSC in the instant case. However, as mentioned

[7] The marginal costing method under section 925(b)(2) does not apply to leases of property and, thus, may not be used to increase FSC exemptions with respect to property that is leased and subleased. Temp. Treas. Reg. § 1.925(b)-1T(a).

above, this advice does not address the treatment of CorpA's controlled foreign corporations that elected to be treated as partnerships for United States tax purposes.

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(International)