Excise Tax Advisory

State of Washington
Department of Revenue
REVENUE

Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

NUMBER: 558.04.193 CONVERSION DATE: July 1, 1998

This ETA is cancelled effective January 29, 2009. FSCs were a status under the Internal Revenue Code and are no longer authorized. This ETA is obsolete.

FOREIGN SALES CORPORATIONS

Issued December 31, 1992

This Excise Tax Bulletin explains the business and occupation (B&O) tax liability of Foreign Sales Corporations (FSCs). A FSC is a corporation which qualifies as a FSC under the Internal Revenue Code ("Code"). Generally, FSCs are export corporations formed by domestic parents for transacting export sales.

For tax years beginning after December 31, 1984, the Code generally replaced Domestic International Sales Corporations (DISCs) with FSCs. Although DISCs have generally been eliminated, certain DISCs, known as "interest charge" DISCs, may continue to operate. See: ETB 448.04.193C which explains the B&O tax liability of DISCs. In contrast to DISCs, the Code requires FSCs to have a substantial foreign presence.

The B&O tax liability of a FSC depends on whether it operates on a direct buy-sell basis or on a commission basis. If a FSC operates on a commission basis, its B&O tax liability depends on whether it is a "Regular" or "Small" FSC.

Buy-Sell FSCs. A Buy-Sell FSC acts as the direct seller of the products transferred to it by its supplier (generally the parent corporation). The supplier generally transfers the product to the FSC at a discounted price, after the stream of foreign commerce has begun. The FSC, in turn, makes the sale to the foreign purchaser. The gross receipts of both the parent and the FSC from such export sales are exempt from B&O tax, if the parent and the FSC maintain documentary proof of export. See: WAC 458-20-193C (Rule 193C) for documentary proof of export requirements.

ETBS have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.

Please direct comments to:
Department of Revenue
Legislation & Policy Division
P O Box 47467
Olympia, Washington 98504-7467
(360) 753-4161 eta@DOR.wa.gov

To inquire about the availability of receiving this document in an alternate format for the visually impaired or language other than English, please call (360)705-6715. Teletype (TTY) users please call 1-800-451-7985.

Commission FSCs. A Commission FSC acts as the sales agent or broker for its supplier (generally the parent corporation), which sells the products in the supplier's own name. The FSC is a conduit through which export sales are made. A Commission FSC provides a distinct and compensable service to its supplier.

The gross sales commission received by the FSC is taxable under the Service Classification of the B&O tax, subject to the apportionment provisions of RCW 82.04.460 and WAC 458-20-194 (Rule 194). Because the Code imposes different requirements upon Regular FSCs and Small FSCs that may affect their out-of-state costs for apportionment purposes, different apportionment principles apply to Regular Commission FSCs and Small Commission FSCs. The FSC's status as a Regular FSC or a Small FSC for federal tax reporting purposes is determinative of its status for B&O tax purposes.

Regular Commission FSCs. In contrast to a DISC and a Small FSC, a Regular FSC must meet tests which ensure that it incurs substantial foreign costs. Specifically, if its receipts are to qualify for federal tax benefits, the FSC must satisfy the "foreign management" and "foreign economic processes" tests. The foreign economic processes test is comprised of two subtests, both of which must be satisfied: the "foreign sales activities" and "foreign direct costs" subtests.

For B&O tax apportionment purposes, the foreign direct costs subtest is critical because it requires the FSC to incur substantial foreign costs with respect to each transaction. To satisfy the Code's foreign direct costs subtest, either (1) the aggregate foreign direct costs incurred by the FSC attributable to the transaction must equal or exceed 50% of the aggregate "total direct costs" attributable to the transaction, or (2) the foreign direct costs attributable to at least two of five enumerated activities must equal or exceed 85% of the total direct costs associated with those activities ("the 85% test").

The majority of Regular Commission FSCs rely on the 85% test to qualify for federal tax benefits. The Department will accept this reporting percentage as a "safe harbor" tax reporting mechanism.

For periods prior to January 1, 1993, the Department will not assess additional B&O tax against any Regular Commission FSC with respect to its commission sales if the FSC reports B&O tax under the Service Classification based on 15% of its gross sales commissions. The FSC will not be permitted to report less than 15% of its gross sales commissions.

For periods commencing on or after January 1, 1993, FSCs will be presumed to incur 85% of their costs outside this state. The FSC will not be permitted to report less than 15% of its gross sales commissions unless it seeks advance approval by the Department to report on an actual cost method and maintains records to substantiate that its out-of-state costs of doing business are in excess of 85% of its total costs of doing business. Likewise, if the Department discovers that less than 85% of the costs are actually incurred outside this state, the Department may notify the taxpayer to start reporting tax on an actual cost method for future periods. The reporting method used whether "safe harbor" or actual cost, shall be used by the taxpayer until a Department approved change in method is received by the FSC.

Small Commission FSCs. In contrast to Regular FSCs, Small FSCs are exempt from both the foreign management and foreign economic processes requirements of the Code and need not incur substantial foreign costs to qualify for federal tax benefits. Because the 85% test does not apply to Small

FSCs, a Small Commission FSC is taxable on 100% of its commission income unless it maintains records to substantiate its actual out-of-state costs of doing business.