

regulatory restrictions on the investment of such assets. This paragraph (g) does not apply to ordinary working capital, which is available for unrestricted use.

(h) *Customer relationship.* Whether a customer relationship exists is determined by reference to all the facts and circumstances. Such a relationship does not exist with respect to transactions between members of a related group, as defined in paragraph (i)(4) of this section, or transactions with any shareholders, officers, directors or other employees of any person that would otherwise be treated as an active bank or qualified bank affiliate if one of the principal purposes for such transactions was to satisfy the requirements of this section.

(i) *Income earned by qualified bank affiliates*—(1) *General rule.* A foreign corporation that is not an active bank but which derives banking income, as defined in paragraph (f)(1) of this section, is a qualified bank affiliate for purposes of this section if such corporation meets the requirements of paragraph (i)(2) of this section and the related group of which it is a member meets the requirements of paragraph (i)(3) of this section. Banking income earned by a qualified bank affiliate is nonpassive only for purposes of determining whether any member of the related group is a passive foreign investment company or holds stock in a passive foreign investment company or for purposes of applying section 956A(c)(2)(A). However, banking income of a qualified bank affiliate remains passive with respect to persons who own stock in that affiliate but who are not members of the related group of which the affiliate is a member.

(2) *Affiliate income requirement.* To be a qualified bank affiliate, at least 60 percent of the foreign corporation's total gross income for the taxable year must be banking income, securities income, as defined in § 1.1296-6(e)(1), or gross income described in section 1296(b)(2)(B) (relating to insurance activities). For purposes of applying this paragraph (i)(2), the look-through rules of sections 1296(b)(2)(C) and 1296(c) do not apply.

(3) *Group income requirements.* The related group qualifies under this paragraph (i) if—

(i) At least 30 percent of the aggregate gross financial services income, as defined in § 1.904-4(e)(1), earned during the taxable year by members of the related group is banking income earned by active banks who are members of the related group during the current taxable year; and

(ii) At least 70 percent of the aggregate gross financial services income earned

during the taxable year by members of the related group is banking income, securities income, or gross income described in section 1296(b)(2)(B) (relating to insurance activities).

(4) *Related group.* The related group is the group of persons consisting of the entity being tested under this paragraph (i) and all entities that are related within the meaning of section 954(d)(3) to such entity, substituting "person" for "controlled foreign corporation" each time the latter term appears.

(j) *Income from nonbank activities.* Income derived from the conduct of activities other than banking activities described in paragraph (f)(2) of this section and income from assets held for the conduct of such other activities are nonpassive only to the extent otherwise provided in section 1296.

(k) *Effective date.* This section is effective for taxable years beginning after December 31, 1994. However, taxpayers may apply this section to a taxable year beginning after December 31, 1986, but must consistently apply this section to such taxable year and all subsequent years.

Par. 5. Section 1.1296-6 is added to read as follows:

§ 1.1296-6 Characterization of certain securities income.

(a) *General rule.* For purposes of section 1296, securities income earned by an active dealer or active broker, as defined in paragraph (b) of this section, or a qualified securities affiliate, as defined in paragraph (j) of this section, is nonpassive income. This section applies only for purposes of determining whether a controlled foreign corporation, as defined in section 957(a), is a passive foreign investment company with respect to its United States shareholders as defined in section 951(b), or for the purpose of determining whether an asset is passive under section 956A(c)(2)(A).

(b) *Active dealer or broker*—(1) *General rule.* A securities dealer, as defined in paragraph (c) of this section, or a securities broker, as defined in paragraph (d) of this section, is an active dealer or an active broker for purposes of this section if it meets the requirements of either paragraph (b) (2) or (3) of this section.

(2) *U.S. licensed dealers and brokers.* A securities dealer or securities broker (whether foreign or domestic) is an active dealer or an active broker if it is registered as a securities dealer or broker under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities

dealer or broker under section 15C(a) of such Act.

(3) *Other dealers and brokers*—(i) *General rule.* A securities dealer or a securities broker is an active dealer or an active broker if it meets the licensing requirements of paragraph (b)(3)(ii) of this section and actively conducts, within the meaning of § 1.367(a)-2T(b)(3), one or more securities activities, as defined in paragraph (e)(2) of this section, as a trade or business within the meaning of § 1.367(a)-2T(b)(2).

(ii) *Licensing requirements.* To be an active dealer or an active broker under paragraph (b)(3) of this section, a securities dealer or securities broker must be licensed or authorized in the country in which it is chartered, incorporated or organized to conduct one or more of the securities activities described in paragraph (e)(2) of this section with residents of that country. The conduct of such activities must be subject to *bona fide* regulation, including appropriate reporting, monitoring and prudential (including capital adequacy) requirements, by a securities regulatory authority in that country that regularly enforces compliance with such requirements and prudential standards.

(c) *Securities dealer.* For purposes of this section, a securities dealer is a dealer (whether foreign or domestic) in securities within the meaning of section 475(c)(1).

(d) *Securities broker.* For purposes of this section, a securities broker is a corporation (whether domestic or foreign) that, during its taxable year, stands ready, in the ordinary course of its trade or business, to effect transactions in securities and other financial instruments for the account of customers, including the arrangement of loans of securities owned by customers.

(e) *Securities income*—(1) *General rule.* Securities income means the gross income (except as provided in paragraph (i) of this section) derived from the active conduct (within the meaning of § 1.367(a)-2T(b)(3)) of any securities activity described in paragraph (e)(2) of this section.

(2) *Securities activities.* For purposes of this section, the following are securities activities—

(i) Purchasing or selling stock, debt instruments, interest rate or currency futures or other securities or derivative financial products (including notional principal contracts) from or to customers and holding stock, debt instruments and other securities as inventory for sale to customers, unless the relevant securities or derivative financial products (including notional