

principal contracts) are not held in a dealer capacity;

(ii) Effecting transactions in securities for customers as a securities broker;

(iii) Arranging futures, forwards, options, or notional principal contracts for, or entering into such transactions with, customers;

(iv) Arranging foreign exchange transactions (including any section 988 transaction within the meaning of section 988(c)(1)) for, or engaging in foreign exchange transactions with, customers;

(v) Underwriting issues of stocks, debt instruments, or other securities under best efforts or firm commitment agreements with customers;

(vi) Purchasing, selling, discounting, or negotiating for customers on a regular basis notes, drafts, checks, bills of exchange, acceptances or other evidences of indebtedness;

(vii) Borrowing or lending stocks or securities for customers;

(viii) Engaging in securities repurchase or reverse repurchase transactions with customers;

(ix) Engaging in hedging activities directly related to another securities activity described in this paragraph (e)(2);

(x) Repackaging mortgages and other financial assets into securities and servicing activities with respect to such financial assets (including the accrual of interest incidental to such activities);

(xi) Engaging in financing activities typically provided by an investment bank, such as—

(A) Project financing provided in connection with, for example, construction projects;

(B) Structured finance, including the extension of a loan and the sale of participations or interests in the loan to other financial institutions or investors; and

(C) Leasing activities to the extent incidental to financing activities described in this paragraph (e)(2)(xi) or to advisory services described in paragraph (e)(2)(xii) of this section;

(xii) Providing financial or investment advisory services, investment management services, fiduciary services, trust services or custodial services;

(xiii) Providing margin or any other financing for a customer secured by securities or money market instruments, including repurchase agreements, or providing financing in connection with any of the activities listed in paragraphs (e)(2)(i) through (e)(2)(xii) of this section;

(xiv) Maintaining deposits of capital (including money or securities) described in paragraph (f) of this section; and

(xv) Any other activity that the Commissioner determines, through a revenue ruling or other formal published guidance, to be a securities activity generally conducted by active dealers or active brokers in the ordinary course of their securities business.

(f) *Certain deposits of capital.* A deposit of capital is, for purposes of this section, a securities activity if the deposit is maintained in a segregated account in order to satisfy a capital requirement for registration as a securities broker or dealer under the laws of a jurisdiction in which the broker or dealer actively conducts (within the meaning of § 1.367(a)-2T(b)(3)) a trade or business (within the meaning of § 1.367(a)-2T(b)(2)) as a securities broker or dealer. A deposit of capital qualifies under this paragraph (f) if and only to the extent that the assets are not available for use in connection with the controlled foreign corporation's activities as a securities broker or dealer because of significant regulatory restrictions on the investment of such assets. This paragraph (f) does not apply to ordinary working capital, which is available for unrestricted use.

(g) *Dealer-customer relationship.* Whether a dealer-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 (j)(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 dealer, active broker or qualified securities affiliate if one of the principal purposes for such transactions was to satisfy the requirements of this section.

(h) *Investment income.* Income earned on any securities held for investment within the meaning of section 475(b)(1)(A) or not held for sale within the meaning of section 475(b)(1)(B), is passive for purposes of sections 1296(a)(1), 1296(a)(2) and 956A(c)(2)(A).

(i) *Calculation of gross income from a matched book.* Securities income includes only the net (not gross) income from matched transactions. For purposes of this section, a matched transaction is a sale and repurchase agreement with respect to the same security properly treated as offsetting agreements in a matched book.

(j) *Income earned by qualified securities affiliates—(1) General rule.* A foreign corporation that is not an active dealer or an active broker but which derives securities income described in paragraph (e)(1) of this section is a qualified securities affiliate for purposes of this section if such corporation meets

the requirements of paragraph (j)(2) of this section and is a member of a related group that meets the requirements of paragraph (j)(3) of this section.

Securities income earned by a qualified securities 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, securities income of a qualified securities 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 securities affiliate, at least 60 percent of the foreign corporation's total gross income for the taxable year must be banking income, as defined in § 1.1296-4(f)(1), securities income, as defined in paragraph (e)(1) of this section, or gross income described in section 1296(b)(2)(B) (relating to insurance activities). For purposes of this paragraph (j)(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 (j) 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 securities income earned by active dealers or active brokers 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 (j) 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.

(5) *Example.* The following example illustrates the rules of this paragraph (j).

*Example. (i) Facts.* SD is a country Y corporation that owns 85 percent of the stock of M, a country Z corporation. A, a U.S. person, owns the remaining 15 percent of the stock of M. B, C, and D, all unrelated U.S. persons, own 5, 15, and 36 percent, respectively, of the stock of SD. The rest of SD's stock is publicly held. SD is a securities dealer within the meaning of section