1976 through 1978 in qualified investments in foreign base company shipping operations are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>$23,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>1977</td>
<td>$28,000</td>
<td>$23,000</td>
</tr>
<tr>
<td>1978</td>
<td>$30,000</td>
<td>$28,000</td>
</tr>
</tbody>
</table>

Example 2. Assume the same facts as in example 1, except that M never files an election under §1.955A–4(b)(1). X’s increases for 1976 through 1978 in qualified investments in foreign base company shipping operations are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>$17,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>1977</td>
<td>$23,000</td>
<td>$17,000</td>
</tr>
<tr>
<td>1978</td>
<td>$28,000</td>
<td>$23,000</td>
</tr>
</tbody>
</table>

Example 3. The facts are the same as in example 1, except that X’s qualified investments in foreign base company shipping operations include an investment in less developed country shipping companies described in §1.955–5(b) of $500 on December 31, 1975, and $50 on December 31, 1976. Assume further that M has made an election under section 955(b)(3) (as in effect before the enactment of the Tax Reduction Act of 1975) with respect to X’s taxable year 1975. Then X’s increase in qualified investments in foreign base company shipping operations for 1976 is $6,750 (i.e., $7,000 – $250).

Illustration. The application of this section may be illustrated by the following example:

Example. (a) Controlled foreign corporation X uses the calendar year as the taxable year. On December 31, 1975, X’s qualified investments in foreign base company shipping operations (determined as provided in §1.955A–2(g)) consist of the following amounts:

- Cash: $6,000
- Readily marketable securities: $1,000
- Stock of related controlled foreign corporations: $4,000
- Traffic and other receivables: $14,000
- Marine insurance claims receivables: $1,000
- Prepaid shipping expenses and shipping inventories ashore: $1,000
- Vessel construction funds: $1,000
- Vessels: $123,000
- Vessel plans and construction in progress: $3,000
- Containers and chassis: $0
- Terminal property and equipment: $2,000
- Shipping office (land and building): $1,000
- Performance deposits: $2,000
- Deferred charges: $2,000
- Stock of less developed country shipping company described in §1.955–5(b): $0

Total: $172,000

(b) On December 31, 1976, X’s qualified investments in foreign base company shipping operations (determined as provided in §1.955A–2(g)) consists of the following amounts:

- Cash: $5,000
- Readily marketable securities: $2,000

Total: $7,000

Stock of related controlled foreign corporations: $4,000
Traffic and other receivables: $16,000
Foreign income tax refunds receivable: $3,000
Prepaid shipping expenses and shipping inventories ashore: $2,000
Vessel construction funds: $1,000
Vessels: $117,000
Vessel plans and construction in progress: $12,000
Containers and chassis: $4,000
Terminal property and equipment: $2,000
Shipping office (land and building): $1,000
Vessel spare parts ashore: $1,000
Performance deposits: $2,000
Deferred charges: $2,000
Stock of less developed country shipping company described in §1.955–5(b): $0

Total: $174,000

Increase for 1976: $2,000

Example 4. Assume the same facts as in example 1, except that M never files an election under §1.955A–4(b)(1). X’s increases for 1976 through 1978 in qualified investments in foreign base company shipping operations include an investment in less developed country shipping companies described in §1.955–5(b) of $500 on December 31, 1975, and $50 on December 31, 1976. Assume further that M has made an election under section 955(b)(3) (as in effect before the enactment of the Tax Reduction Act of 1975) with respect to X’s taxable year 1975. Then X’s increase in qualified investments in foreign base company shipping operations for 1976 is $6,750 (i.e., $7,000 – $250).

(c) For 1976, X’s increase in qualified investments in foreign base company shipping operations is $2,000, which amount is determined as follows:

Qualified investments at Dec. 31, 1976: $174,000
Qualified investments at Dec. 31, 1975: $172,000
Increase for 1976: $2,000

[T.D. 7894, 48 FR 22528, May 19, 1983]
is determined generally under the principles of §§1.861–1 to 1.863–5. See §1.863–6. Thus, income from the performance of a service generally is sourced in the country where the service is performed. See §1.861–4. Underwriting income from insuring a foreign oil related activity is sourced at the location of the risk. See section 861(a)(7) and §1.953–2.  

(3) **Primary product.** The term “primary product” of oil or gas has the meaning given this term by §1.907(c)–1(d)(5) and (6).  

(4) **Vessel.** For the definition of the term “vessel”, see §1.954–6(b)(3)(ii).  

(5) **Foreign country.** For purposes of this section, the term “foreign country” has the same meaning as in section 638 (relating to continental shelf areas). Thus, for example, oil or gas extracted from a sea area will be deemed to be extracted in the country which has exclusive rights of exploitation of natural resources with respect to that area if the other conditions of section 638 are met.  

(6) **Country of use or consumption.** For rules for determining the country of use or consumption, see §1.954–3(a)(3)(ii).  

(7) **Insurance income.** For purposes of this section, income derived from or attributable to insurance of section 907(c)(2) activities means taxable income as defined in section 832(a) and as modified by the principles of §1.953–4 (other than as the section is applied to life insurance).  

(8) **Fuel product.** For purposes of this section, the term “fuel product” means oil, gas or a primary product of oil or gas.  

(9) **Effective date.** The provisions of section 954(g) and this section are applicable to taxable years of foreign corporations beginning on or after January 1, 1983, and to taxable years of United States shareholders in which or with which those taxable years of foreign corporations end.  

(c) **Special rules for applying the extraction exception of paragraph (a)(1)(i) of this section.**—(1) **Refining income described in section 907(c)(2)(A).** With regard to a controlled foreign corporation’s refining income from the processing of minerals extracted (by the taxpayer or by any other person) from oil or gas wells into their primary products, as described in section 907(c)(2)(A), a pro rata method will be applied for purposes of determining the part of the refining income that qualifies for the extraction exception of paragraph (a)(1)(i) of this section. The pro rata method will be based on the proportion that the barrels of the fuel product extracted in the country of processing bears to the total barrels of the fuel product processed in that country and will apply regardless of the country of sale of the primary product.  

(2) **Marketing income described in section 907(c)(2)(C).** With regard to a controlled foreign corporation’s marketing income from the distribution or sale of minerals extracted from oil or gas wells or of primary products, as described in section 907(c)(2)(C), a pro rata method will be applied for purposes of determining the part of the marketing income that qualifies for the extraction exception of paragraph (a)(1)(i) of this section. When applying the pro rata method to the sale of a fuel product other than a primary product, the pro rata method will be based on the proportion that the barrels of the fuel product extracted in the country of sale bears to the total barrels of the fuel product sold in that country. When applying the pro rata
method to the sale of primary products, the method will be based on the proportion that the barrels of the fuel product extracted in the country of sale bears to the total barrels of the fuel product processed. For purposes of applying the pro rata method, data of the controlled foreign corporation’s related group (as defined in section 954(g)(2)(C)) will be taken into account. The pro rata method will not apply, however, if the mineral or primary product is purchased by the controlled foreign corporation from a person not within the controlled foreign corporation’s related group. In that situation, the marketing income will be presumed to qualify for the extraction exception if the country of the source of the marketing income is a net exporter of crude oil or gas, whichever is relevant. If the country of the source of the marketing income is not a net exporter of crude oil or gas, whichever is relevant, the marketing income will be presumed not to qualify for the extraction exception. The controlled foreign corporation may, however, rebut this latter presumption by demonstrating on the basis of all the facts and circumstances that its marketing income does qualify for the extraction exception. If a primary product that is acquired from a person within the controlled foreign corporation’s related group is commingled with like products acquired from persons not within that related group, the pro rata method based on the proportion that the barrels of the fuel product extracted in the country of sale bears to the total barrels of the fuel product processed will be applied to that portion of the total products sold that was purchased from persons within the related group, to the extent that that person did not sell product purchased from an unrelated person, and either the presumption or facts and circumstances will determine the characterization of the remainder.

(3) Transportation income described in section 907(c)(2)(B). With regard to a controlled foreign corporation’s income from the transportation of minerals from oil and gas wells or of primary products, as described in section 907(c)(2)(B), the rules set forth in paragraph (c)(2) of this section will apply for purposes of determining the part of the transportation income that qualifies for the extraction exception of paragraph (a)(1)(i) of this section.

(4) Illustrations. The following examples illustrate the application of this paragraph.

Example 1. Controlled foreign corporation M has a refinery in foreign country A that refines 250x barrels of oil during its taxable year beginning in 1984. It is determined that 125x barrels of its 250x barrels were extracted in country A. M sold 150x barrels of its 250x barrels in country A for consumption in country A which resulted in $225x of income from refining and $225x of marketing income, as described in section 907(c)(2)(C). M also sold within foreign country B, for consumption in country B, 100x barrels of its 250x barrels which resulted in an additional $150x of income from refining for M and $170x of marketing income for M. The 100x barrels sold by M within country B, a contiguous country, were transported from M’s refinery in country A to country B by a pipeline which is owned by M, and M recognized a total of $10x of income from the transportation of the 100x barrels. Of this $10x, $8x was recognized in country A and $2x was recognized in country B. Under the source of income rules of paragraph (a)(2) of this section, income from refining is considered derived from the country in which the refining occurs and not from the country where the sale of the refined product occurs.

(i) M’s refining income. M has $75x of foreign base company oil related income with respect to its refining of the 250x barrels, determined as follows:

(A) Total amount of income from refining attributable to oil refined in country A by M.........................$375x

(B) Amount of income from refining with respect to oil sold for consumption ($225x) in country A (use or consumption exception under paragraph (a)(1)(i) of this section

.........................................................(225x)

(C) Pro rate amount of income from refining attributable to sales in country B considered extracted from country A ($150x times 125x barrels/250x barrels) (extraction exception under paragraph (a)(1)(ii) of this section............................................(75x)

(D) Foreign base company oil related income...............................................$75x

(ii) M’s marketing income. M does not have foreign base company oil related income with respect to its sale of the 100x barrels in country B and 150x barrels in country A because the $170x and $225x, respectively, of marketing income was derived from the
§ 1.954–8

country in which the oil was sold for consumption (an exception under paragraph (a)(1)(i) of this section).

(iii) M’s transportation income. M does not have foreign base company oil related income with respect to its $6x of pipeline transportation income recognized in country B because the income was derived from the country in which the 100x barrels were sold for consumption, an exception under paragraph (a)(1)(ii) of this section. With regard to the $8x of pipeline transportation income recognized in country A, however, M has $4x of foreign base company oil related income since the total barrels refined in country A (250x) only one-half were extracted in that country. Therefore, only one-half of the transportation income qualifies for the extraction exception of paragraph (a)(1)(i) of this section.

(iv) M’s extraction income. M does not have foreign base company oil related income for its extraction activity because extraction income is excluded in all events. See section 954(g)(1)(A).

Example 2. Assume the same facts as in Example 1 except that M sold all of the 250x barrels of refined oil in country A. In addition, assume that country A is a net exporter of crude oil. As in Example 1, M sold 150x barrels for consumption in country A with the same resulting income. M sold in country A the remaining 100x barrels to unrelated controlled foreign corporation N which resulted in an additional $150x of income from refining for M and $170x of marketing income for M. N immediately resold in country A for export those 100x barrels. N did not commingle the 100x barrels with any other refined oil. N earned $10x of marketing income on that sale.

(i) M’s refining income. M has $75x foreign base company oil related income attributable to oil refined in country A by M $375x

(ii) Amount of income from refining with respect to its refining of the 250x barrels determined as follows:

(A) Total amount of income from refining attributable to oil refined in country A by M $375x

(B) Pro rata amount of income from refining attributable to oil product considered extracted in country A ($170x times 125x barrels/250x barrels) (extraction exception under paragraph (a)(1)(i) of this section) $85x

(C) Foreign base company oil related income $85x

Example 3. Assume the same facts as in Example 2 except that N sold all of the 100x barrels, determined as follows:

(A) Total amount of marketing income from the sale $170x

(B) Pro rata amount of marketing income attributable to oil product considered extracted in country A ($170x times 125x barrels/250x barrels) (extraction exception under paragraph (a)(1)(i) of this section) $85x

(C) Foreign base company oil related income $85x

Example 4. Assume that controlled foreign corporation M has a refinery in foreign country A that refines 200x barrels of oil during its taxable year beginning in 1984. It is determined that 100x barrels of that oil were extracted in country A and that the other 100x barrels were extracted in country B. Neither country A nor country B is a net exporter of crude oil. In addition, M purchased from an unrelated country A refiner 100x barrels of already refined oil. M does not know where this oil was extracted. These 100x barrels of purchased refined oil were commingled with the 200x barrels of refined oil from M’s refinery. M sold 250x barrels of refined oil in country A which resulted in $250x of income from refining and $225x of marketing income. M sold within foreign country B for consumption outside of country B 75x barrels of refined oil

26 CFR Ch. I (4–1–11 Edition)
Internal Revenue Service, Treasury

§ 1.955–0

which resulted in $100x of income from refining and $75x of marketing income. The refined product was transported between country A and country B by an unrelated person. (A) Total amount of income from refining attributable to oil refined in country A by M

(B) Amount of income from refining with respect to oil sold for consumption in country A ($250x use or consumption exception under paragraph (a)(1)(i) of this section)

(C) Pro rata amount of income from refining attributable to sales in country B considered extracted from country A ($100x times 100x barrels/200x barrels) (extraction exception under paragraph (a)(1)(i) of this section)

(D) Foreign base company oil related income

§ 1.955–0

Effective dates.

(a) Section 955 as in effect before the enactment of the Tax Reduction Act of 1975—(1) In general. In general, §§1.955–1 through 1.955–6 are applicable with respect to withdrawals of previously excluded subpart F income from qualified investment in less developed countries for taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States shareholders (as defined in section 951(b)) within which or with which such taxable years of such foreign corporations end. However, such sections are effective with respect to withdrawals of amounts invested in less developed country shipping companies described in section 955(c)(2) (as in effect before the enactment of the Tax Reduction Act of 1975) only for taxable years of foreign corporations beginning before January 1, 1976, and for taxable years of United States shareholders (as defined in section 951(b)) within which or with which such taxable years of such foreign corporations end. For rules applicable to withdrawals of amounts invested in less developed country shipping companies described in section


351