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under the special sourcing rule, the foreign source income of R shall not exceed $25.

Example 2. (i) Assume the same facts as in *Example 1* except that R and F used the gross receipts pricing rule of section 925(a)(1). In addition, for the taxable year foreign trading gross receipts derived from the sale of the export property are $2,000.

(ii) Under section 925(a)(1), 1.83 percent of the $2,000 foreign trading gross receipts ($36.60) is allocated to F and the $63.40 remaining combined taxable income ($100 − $36.60) is allocated to R. Absent the special sourcing rule, under section 863(b) the $63.40 income allocated to R would be sourced $31.70 U.S. source and $31.70 foreign source. Under the special sourcing rule, the amount of foreign source income earned by a related supplier of a FSC shall not exceed the amount that would result if the corresponding DISC pricing rule applied. The DISC gross receipts pricing rule of section 994(a)(1) corresponds to the gross receipts pricing rule of section 925(a)(1). Under section 994(a)(1), $80 ($2,000 × .04) would be allocated to the DISC and the $20 remaining combined taxable income would be allocated to the related supplier. Under section 863(b), the $20 income allocated to the DISC's related supplier would be sourced $10 U.S. source and $10 foreign source. Accordingly, under the special sourcing rule, the foreign source income of R shall not exceed $10.

(c) *Effective date.* The rules of this section are applicable to taxable years beginning after December 31, 1997.

[T.D. 8782, 63 FR 50144, Sept. 21, 1998]

§ 1.927(e)–2T Temporary regulations; effect of boycott participation on FSC and small FSC benefits.

(a) *International boycott factor.* If the FSC (or small FSC) or any member of the FSC's (or small FSC's) controlled group participates in or cooperates with an international boycott within the meaning of section 999, the FSC's (or small FSC's) exempt foreign trade income as determined under section 923 (a) shall be reduced by an amount equal to the product of the FSC's (or small FSC's) exempt foreign trade income multiplied by the international boycott factor determined under section 999. The amount of the reduction will be considered as non-exempt foreign trade income.

(b) *Specifically attributable taxes and income method.* If the taxpayer clearly demonstrates that the income earned for the taxable year is attributable to specific operations, then in lieu of applying the international boycott factor for such taxable year, the amount of the exempt foreign trade income as determined under section 923(a) that will be reduced by this section shall be the amount specifically attributable to the operations in which there was participation in or cooperation with an international boycott under section 999(b)(1). The amount of the reduction will be considered as non-exempt foreign trade income.

[T.D. 8126, 52 FR 6465, Mar. 3, 1987]

§ 1.927(f)–1 Election and termination of status as a Foreign Sales Corporation.

(a) *Election of status as a FSC or a small FSC.*

Q–1. What is the effect of an election by a corporation to be treated as a FSC or small FSC?

A–1. A valid election to be treated as a FSC or a small FSC applies to the taxable year of the corporation for which made and remains in effect for all succeeding taxable years in which the corporation qualifies to be a FSC unless revoked by the corporation or unless the corporation fails for five consecutive years to qualify as a FSC (in case of a FSC election) or as a small FSC (in case of a small FSC election).

Q–2. Can a corporation established prior to January 1, 1985 be treated as a FSC or a small FSC prior to making a FSC or a small FSC election?

A–2. A corporation cannot be treated as a FSC or a small FSC until it has made a FSC or a small FSC election. An election made within the first 90 days of 1985 relates back to January 1, 1985 unless the taxpayer indicates otherwise.

Q–3. If a shareholder who has not consented to a FSC or small FSC election transfers some or all of its shares before or during the first taxable year for which the election is made, may the holder of the transferred shares consent to the election?

A–3. A holder of the transferred shares may consent to a FSC or small FSC elction under the circumstances described in §1.922–2(c)(1). The rules contained in §1.992–(c) shall apply to the consent by a holder of transferred shares.