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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.

Q–4. If a shareholder who has consented to a FSC or a small FSC election transfers some or all of its shares before the first taxable year for which the election is made, must the holder of the transferred shares consent to the election?

A–4. Yes. Consent must be made by any recipient of such shares on or before the 90th day after the first day of such first taxable year. If such recipient fails to file his consent on or before such 90th day, and extension of time for filing such consent may be granted in the manner, and subject to the conditions, described in paragraph (b)(3) of §1.992–2.

Q–5. May an election of a corporation to be a FSC or a small FSC be effective as of a time other than the start of the corporation's taxable year?

A–5. No.

Q–6. If a fiscal year foreign corporation was in existence on December 31, 1984, must it wait until the first day of its taxable year beginning after January 1, 1985, to elect FSC status?

A–6. No. If a fiscal year foreign corporation was in existence on December 31, 1984, its taxable year will be deemed to have terminated on that date if the foreign corporation elects FSC status to be effective January 1, 1985. An income tax return will be required for any short years created by the deemed closing of the taxable year unless the corporation is relieved from the necessity of making a return by section 6012 and the regulations under that section. If the corporation's taxable year is deemed closed by operation of this regulation, the filing date of tax returns for the short taxable year ended on December 31, 1984, will be automatically extended until May 18, 1987.

Q–7. What is the effect of an election to be treated as a FSC or as a small FSC if the corporation or any other member of the controlled group has in effect an election to be treated as an interest charge DISC?

A–7. The interest charge DISC election shall be treated as revoked for all purposes under the Code as of the date the FSC election is effective. An affirmative revocation of the DISC election is unnecessary. The FSC election shall take effect. As long as the FSC election remains in effect, neither the corporation nor any other member of the controlled group is permitted to elect to be treated as an interest charge DISC for any taxable year including any part of a taxable year during which the corporation's FSC election continues to be effective.

Q–8. What is the effect of an election to be treated as a small FSC if the corporation or any other member of the controlled group has in effect an election to be treated as a FSC?

A–8. As long as a FSC election remains in effect, neither the corporation nor any other member of the controlled group is permitted to elect to be treated as a small FSC for any taxable year including any part of a taxable year during which a FSC election continues to be effective. Any FSC within the controlled group must affirmatively revoke its FSC election for a taxable year including any part of a taxable year for which small FSC status is elected.

Q–9. What is the effect of an election to be treated as a FSC if the corporation or any other member of the controlled group has in effect an election to be treated as a small FSC?

A–9. As long as a small FSC election remains in effect, neither the corporation nor any other member of the controlled group is permitted to elect to be treated as a FSC for any taxable year including any part of the taxable year during which a small FSC election continues to be effective. Any small FSC within the controlled group must affirmatively revoke its small FSC election for a taxable year including any part of a taxable year for which FSC status is elected. An election to be treated as a small FSC is permitted if the corporation or any other member of the controlled group has in effect an election to be treated as a small FSC. For a special rule providing for conversion of a small FSC to a FSC within one taxable year, see §1.921–1T(b)(1) (Q&A–1).

(b) *Termination of election of status as a FSC or a small FSC*.

Q–10. How is the status of a corporation as a FSC or as a small FSC terminated?

A–10. The status of a corporation as a FSC or as a small FSC is terminated

through revocation or by its continued failure to be a FSC.

Q–11. For what taxable year may a corporation revoke its election to be treated as a FSC or as a small FSC?

A–11. A corporation may revoke its election to be treated as a FSC or as a small FSC for any taxable year of the corporation after the first taxable year for which the election is effective.

Q–12. When must a corporation revoke a FSC or a small FSC election if revocation is to be effective for the taxable year in which revocation takes place?

A–12. If a corporation files a statement revoking its election to be treated as a FSC or as a small FSC during the first 90 days of a taxable year (other than the first taxable year for which such election is effective), such revocation will be effective for such taxable year and all taxable years thereafter. If the corporation files a statement revoking its election to be treated as a FSC or a small FSC after the firs 90 days of a taxable year, the revocation will be effective for all taxable years following such taxable year.

Q–13. Can a FSC change its status to a small FSC, or can a small FSC change its status to a FSC as of a date other than the first day of a taxable year?

A–13. No. Since a revocation of an election to be a FSC or a small FSC is effective only for entire taxable year, a corporation's change between FSC and small FSC status is effective as of the first day of a taxable year.

Q–14. How may a corporation revoke an election by a corporation to be treated as a FSC or a small FSC?

A–14. A corporation may revoke its election by filing a statement that the corporation revokes its election under section 922(a) to be treated as a FSC or under section 922(b) to be treated as a small FSC. Such statement shall indicate the corporation's name, address, employer identification number, and the first taxable year of the corporation for which the revocation is to be effective. The statement shall be signed by any person authorized to sign a corporate return under section 6062. Such revocation shall be filed with the Service Center with which the corporation filed its return.

Q–15. What if the effect is a corporation that has elected to be treated as a FSC or a small FSC fails to qualify as a FSC because it does not meet the requirements of section 922 for a taxable year?

A–15. If a corporation that has elected to be treated as a FSC or a small FSC does not qualify as a FSC or a small FSC for a taxable year, the corporation will not be treated as a FSC or a small FSC for the taxable year. However, the failure of a corporation to qualify to be treated as a FSC or a small FSC for a taxable year does not terminate the election of the corporation to be treated as FSC or a small FSC unless the corporation does not qualify under section 922 for each of 5 consecutive taxable years, as provided in Q&A 16 of this section.

Q–16. Under what circumstances is the FSC or small FSC election terminated for continued failure to be a FSC?

A–16. If a corporation that has elected to be treated as a FSC or a small FSC does not qualify under section 922 to be treated as a FSC or small FSC for each of 5 consecutive taxable years, such election terminates and will not be effective for any taxable year after such fifth taxable year. Such termination will be effective automatically without notice to such corporation or to the Internal Revenue Service.

[T.D. 8127, 52 FR 6475, Mar. 3, 1987]

POSSESSIONS OF THE UNITED STATES

§ 1.931–1 Exclusion of certain income from sources within Guam, American Samoa, or the Northern Mariana Islands.

(a) *General rule.* (1) An individual (whether a United States citizen or an alien), who is a bona fide resident of a section 931 possession during the entire taxable year, will exclude from gross income the income derived from sources within any section 931 possession and the income effectively connected with the conduct of a trade or business by such individual within any section 931 possession, except amounts received for services performed as an employee of the United States or any agency thereof. For purposes of section 931(d) and this section, an employee of