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as foreign base company shipping income, then loss from such sale, exchange, or other disposition is properly allocable to foreign base company shipping income (to the same extent).

(iii) In determining the extent to which any loss on the disposition of a qualified investment in foreign base company shipping operations is deductible from foreign base company shipping income, it is immaterial that such loss is taken into account under §1.955A–1(b)(1)(ii) as a reduction in the amount of the decrease in (withdrawal from) qualified investments in foreign base company shipping operations.

(5) *Hypothetical charges.* Under paragraph (d)(5)(i) of this section and §1.955A–2(a)(4)(ii)(A), gross income may be deemed to include hypothetical arm's length charges for services performed by a controlled foreign corporation for itself. Under paragraph (d)(2) of this section, certain of these hypothetical charges may be treated as foreign based company shipping income. Such hypothetical charges are deemed to be income solely for purposes of applying the ''extent of use'' tests prescribed by paragraph (d)(4) of this section and §1.955A–2(a)(4). Charges for services performed by a controlled foreign corporation for itself shall in no event be included in income for any other purposes.

[T.D. 7894, 48 FR 22523, May 19, 1983]

§1.954–7 Increase in qualified investments in foreign base company shipping operations.

(a) *Determination of investments at close of taxable year*—(1) *In general.* Under section 954(g), the increase in qualified investments in foreign base company shipping operations, for purposes of section 954(b)(2) and paragraph (b)(1) of §1.954–1, of any controlled foreign corporation for any taxable year is, except as provided in paragraph (b) of this section, the amount by which—

(i) The controlled foreign corporation's qualified investments in foreign base company shipping operations at the close of the taxable year, exceed

(ii) Its qualified investments in foreign base company shipping operations at the close of the preceding taxable year.

(2) *Preceding taxable year.* For purposes of this section, a taxable year which begins before January 1, 1976, may be a preceding taxable year.

(3) *Cross-reference.* See section 955 (b) and §1.955A–2 for the definition of the term ''qualified investments in foreign base company shipping operations''.

(b) *Election to determine investments at close of following taxable year*—(1) *General rule.* In lieu of determining an increase in qualified investments in foreign base company shipping operations for a taxable year in the manner provided in paragraph (a) of this section, a United States shareholder of a controlled foreign corporation may make an election under section 955(b)(3) to determine the increase for the corporation's taxable year by ascertaining the amount by which—

(i) Such corporation's qualified investments in foreign base company shipping operations at the close of the taxable year immediately following such taxable year, exceed

(ii) Its qualified investments in foreign base company shipping operations at the close of the taxable year immediately preceding such following taxable year.

(2) *Election with respect to first taxable year.* Notwithstanding subparagraph (1) of this paragraph, if an election is made without consent by a United States shareholder under §1.955A–4(b)(1) with respect to a controlled foreign corporation, the increase in such controlled foreign corporation's qualified investments in foreign base company shipping operations for the first taxable year to which such election applies shall be the amount by which—

(i) Such corporation's qualified investments in foreign base company shipping operations at the close of the taxable year immediately following such first taxable year, exceed

(ii) Its qualified investments in foreign base company shipping operations at the close of the taxable year immediately preceding such first taxable year.

(3) *Manner of making election.* For the manner of making an election under section 955(b)(3), and for rules pertaining to the revocation of such an election, see §1.955A–4.

(4) *Coordination with prior law.* If a United States shareholder makes an election without consent under §1.955A–4(b)(1) with respect to a controlled foreign corporation, then such corporation's increase in qualified investments in foreign base company shipping operations for the first taxable year to which such election applies shall be determined by disregarding any change which occurs during such taxable year in the amount of such corporation's investments in stock or obligations of a less developed country shipping company described in §1.955–5 (b) if both of the following conditions exist:

(i) Such taxable year is the first taxable year of such corporation which begins after December 31, 1975, and

(ii) Such United States shareholder has elected to determine the change in such corporation's qualified investments in less developed countries for its last taxable year beginning before January 1, 1976, under §1.954–5(b) or §1.955–3.

(5) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example 1. (a) Controlled foreign corporation X is a wholly owned subsidiary of domestic corporation M. X uses the calendar year as the taxable year. The amounts of X's qualified investments in foreign base company shipping operations at the close of 1975 through 1979 are as follows:

Qualified investments at December 31, 1975	$16,000
Qualified investments at December 31, 1976	17,000
Qualified investments at December 31, 1977	23,000
Qualified investments at December 31, 1978	28,000
Qualified investments at December 31, 1979	30,000

(b) Assume that M properly files without consent a timely election under §1.955A–4(b)(1) to determine X's increase for 1976 in qualified investments in foreign base company shipping operations pursuant to this paragraph, and that the election remains in force through 1978. Then X's increases for 1976 through 1978 in qualified investments in foreign base company shipping operations are as follows:

Increase for 1976 ($23,000 minus $16,000)	$7,000
Increase for 1977 ($28,000 minus $23,000)	5,000
Increase for 1978 ($30,000 minus $28,000)	2,000

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:

Increase for 1976 ($17,000 minus $16,000)	$1,000
Increase for 1977 ($23,000 minus $17,000)	6,000
Increase for 1978 ($28,000 minus $23,000)	5,000

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 $750 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) *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
Foreign income tax refunds receivable	1,000
Prepaid shipping expenses and shipping inventories ashore	1,000
Vessel construction funds	0
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
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)	10,000
	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
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
	174,000

(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]

§ 1.954–8 Foreign base company oil related income.

(a) *Foreign base company oil related income*—(1) *In general.* Under section 954(g), the foreign base company oil related income of a controlled foreign corporation (except as provided under paragraph (b) of this section) consists of the items of foreign oil related income (''FORI'') described in section 907(c)(2) and (3), other than such income derived from a source within a foreign country in connection with—

(i) Oil or gas which was extracted from an oil or gas well located in that foreign country (''extraction exception''), or

(ii) Oil, gas, or a primary product of oil or gas which is sold by the controlled foreign corporation or a related person for use or consumption within that country or is loaded in that country on a vessel or aircraft as fuel for the vessel or aircraft (''use or consumption exception'').

A taxpayer claiming the use or consumption exception must establish its applicability on the basis of facts and circumstances. For special rules for applying the extraction exception, see paragraph (c) of this section.

(2) *Source of income.* The source of foreign base company oil related income 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.

(b) *Exemption for small oil producers*—(1) *In general.* Foreign base company oil related income does not include any income of a foreign corporation which is not a large oil producer.

(2) *Large oil producer.* A corporation is a large oil producer (within the meaning of section 954(g)(2)) if the average daily production (extraction) of foreign crude oil and natural gas by the related group which includes the corporation and related persons (within the meaning of section 954(d)(3)) for the taxable year or immediately preceding taxable year is 1,000 or more barrels. The average daily production of foreign crude oil or natural gas for any taxable year (and the conversion of cubic feet of natural gas into barrels) is determined