

(C) Combined taxable income for purposes of section 994(a)(2) shall be deemed to be an amount equal to the combined taxable income for purposes of section 925(a)(2) arising from the transaction.

(b) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. (i) R and F are calendar year taxpayers. R, a domestic manufacturing company, owns all the stock of F, which is a FSC acting as a commission agent for R. For the taxable year, R and F used the combined taxable income pricing rule of section 925(a)(2). For the taxable year, the combined taxable income of R and F is \$100 from the sale of export property, as defined in section 927(a), manufactured by R using production assets located in the United States. Title to the export property passed outside of the United States.

(ii) Under section 925(a)(2), 23 percent of the \$100 combined taxable income of R and F (\$23) is allocated to F and the remaining \$77 is allocated to R. Absent the special sourcing rule, under section 863(b) the \$77 income allocated to R would be sourced \$38.50 U.S. source and \$38.50 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 combined taxable income pricing rule of section 994(a)(2) corresponds to the combined taxable income pricing rule of section 925(a)(2). Under section 994(a)(2), \$50 of the combined taxable income (\$100 x .50) would be allocated to the DISC and the remaining \$50 would be allocated to the related supplier. Under section 863(b), the \$50 income allocated to the DISC's related supplier would be sourced \$25 U.S. source and \$25 foreign source. Accordingly, 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 x .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.*