

862. Income from sources without the United States

(a) Gross income from sources without United States. -- The following items of gross income shall be treated as income from sources without the United States:

(1) interest other than that derived from sources within the United States as provided in section 861(a)(1);

(2) dividends other than those derived from sources within the United States as provided in section 861(a)(2);

(3) compensation for labor or personal services performed without the United States;

(4) rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties;

(5) gains, profits, and income from the sale or exchange of real property located without the United States;

(6) gains, profits, and income derived from the purchase of inventory property (within the meaning of section 865(i)(1)) within the United States and its sale or exchange without the United States;

(7) underwriting income other than that derived from sources within the United States as provided in section 861(a)(7); and

(8) gains, profits, and income from the disposition of a United States real property interest (as defined in section 897(c)) when the real property is located in the Virgin Islands.

(b) Taxable income from sources without United States. -- From the items of gross income specified in subsection (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as taxable income from sources without the United States. In the case of an individual who does not itemize deductions, an amount equal to the standard deduction shall be considered a deduction which cannot definitely be allocated to some item or class of gross income.

863. Special rules for determining source

(a) Allocation under regulations. -- Items of gross income, expenses, losses, and deductions, other than those specified in sections 861(a) and 862(a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross

income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(b) Income partly from within and partly from without the United States. -- In the case of gross income derived from sources partly within and partly without the United States, the taxable income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income; and the portion of such taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Secretary. Gains, profits, and income --

(1) from services rendered partly within and partly without the United States,

(2) from the sale or exchange of inventory property (within the meaning of section 865(i)(1)) produced (in whole or in part) by the taxpayer within and sold or exchanged without the United States, or produced (in whole or in part) by the taxpayer without and sold or exchanged within the United States, or

(3) derived from the purchase of inventory property (within the meaning of section 865(i)(1)) within a possession of the United States and its sale or exchange within the United States.

(c) Source rule for certain transportation income. --

(1) Transportation beginning and ending in the United States. -- All transportation income attributable to transportation which begins and ends in the United States shall be treated as derived from sources within the United States.

(2) Other transportation having United States connection. -

(A) In general. -- 50 percent of all transportation income attributable to transportation which --

(i) is not described in paragraph (1), and

(ii) begins or ends in the United States, shall be treated as from sources in the United States.

(B) Special rule for personal service income. --

Subparagraph (A) shall not apply to any transportation income which is income derived from personal services performed by the taxpayer, unless such income is attributable to transportation which --

(i) begins in the United States and ends in a possession of the United States, or

(ii) begins in a possession of the United States and ends in the United States.

(3) Transportation income. -- For purposes of this subsection, the term "transportation income" means any income derived from, or in connection with --

(A) the use (or hiring or leasing for use) of a vessel or aircraft, or

(B) the performance of services directly related to the use of a vessel or aircraft.

For purposes of the preceding sentence the term "vessel or aircraft" includes any container used in connection with a vessel or aircraft.

(d) Source rules for space and certain ocean activities. -

(1) In general. -- Except as provided in regulations, any income derived from a space or ocean activity --

(A) if derived by a United States person, shall be sourced in the United States, and

(B) if derived by a person other than a United States person, shall be sourced outside the United States.

(2) Space or ocean activity. -- For purposes of paragraph (1) --

(A) In general. -- The term "space or ocean activity" means --

(i) any activity conducted in space, and

(ii) any activity conducted on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States. Such term includes any activity conducted in Antarctica.

(B) Exception for certain activities. -- The term "space or ocean activity" shall not include --

(i) any activity giving rise to transportation income (as defined in section 863(c)),

(ii) any activity giving rise to international communications income (as defined in subsection (e)(2)), and

(iii) any activity with respect to mines, oil and gas wells, or other natural deposits to the extent within the United States or any foreign country or possession of the United States (as defined in section 638).

For purposes of applying section 638, the jurisdiction of any foreign country shall not include any jurisdiction not recognized by the United States.

(e) International communications income. --

(1) Source rules. --

(A) United States persons. In the case of any United States person, 50 percent of any international communications income shall be sourced in the United States and 50 percent of such income shall be sourced outside the United States.

(B) Foreign persons. --

(i) In general. -- Except as provided in regulations or clause (ii), in the case of any person other than a United States person, any international communications income shall be sourced outside the United States.

(ii) Special rule for income attributable to office of fixed place of business in the United States. -- In the case of any person (other than a United States person) who maintains an office or other fixed place of business in the United States, any international communications income attributable to such office or other fixed place of business shall be sourced in the United States.

(2) Definition. -- For purposes of this section, the term "international communications income" includes all income derived from the transmission of communications or data from the United States to any foreign country (or possession of the United States) or from any foreign country (or possession of the United States) to the United States.

864. Definitions and special rules

(a) Produced. -- For purposes of this part, the term "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

(b) Trade or business within the United States. -- For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include --

(1) Performance of personal services for foreign employer. -- The performance of personal services --

(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate \$3,000.

(2) Trading in securities or commodities. --

(A) Stocks and securities. --

(i) In general. -- Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

(ii) Trading for taxpayer's own account. -- Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities, or in the case of a corporation (other than a corporation which is, or but for section 541(c)(7), 542(c)(10), or 543(b)(1)(C) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

(B) Commodities. --

(i) In general. -- Trading in commodities through a resident broker, commission agent, custodian, or other independent agent.

(ii) Trading for taxpayer's own account. -- Trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in commodities.

(iii) Limitation. -- Clauses (i) and (ii) shall apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

(C) Limitation. -- Subparagraphs (A)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

(c) Effectively connected income, etc. --

(1) General rule. -- For purposes of this title --

(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), (4), (6), and (7) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Except as provided in paragraph (6) or (7) or in section 871(d) or sections 882(d) and (e), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

(2) Periodical, etc., income from sources within United States -- factors. -- In determining whether income from sources within the United States of the types described in section 871(a)(1), section 871(h), section 881(a), or section 881(c), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether --

(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss. In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business.

(3) Other income from sources within United States. -- All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

(4) Income from sources without United States. --

(A) Except as provided in subparagraphs (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States

to which such income, gain, or loss is attributable and such income, gain, or loss --

(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) derived in the active conduct of such trade or business;

(ii) consists of dividends or interest, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stocks or securities for its own account; or

(iii) is derived from the sale or exchange (outside the United States) through such office or other fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold or exchanged for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer in a foreign country participated materially in such sale.

(C) In the case of a foreign corporation taxable under part I or part II of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

(D) No income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either --

(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

(ii) is subpart F income within the meaning of section 952 (a).

(5) Rules for application of paragraph (4)(B). -- For purposes of subparagraph (B) of paragraph (4) --

(A) in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business, an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the nonresident alien individual or foreign corporation and regularly exercises that authority or has a stock of merchandise form which he regularly fills orders on behalf of such individual or foreign corporation, and (ii) is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,

(B) income, gain, or loss shall not be considered as attributable to an office or other fixed place of business within the United States unless such office or fixed place of business is a material factor in the production of such income, gain, or loss and such office or fixed place of business regularly carries on activities of the type from which such income, gain, or loss is derived, and

(C) the income, gain, or loss which shall be attributable to an office or other fixed place of business within the United States shall be the income, gain, or loss property allocable thereto, but, in the case of a sale or exchange described in clause (iii) of such subparagraph, the income which shall be treated as attributable to an office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale or exchange were made in the United States.

(6) Treatment of certain deferred payments, etc. -- For purposes of this title, in the case of any income or gain of a nonresident alien individual or a foreign corporation which --

(A) is taken into account for any taxable year, but

(B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year,

the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be) shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year referred to in subparagraph (A).

(7) Treatment of certain property transactions. -- For purposes of this title, if --

(A) any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, and

(B) such property is disposed of within 10 years after such cessation,

the determination of whether any income or gain attributable to such disposition is taxable under section 871(b) or 882 (as the case may be) shall be made as if such sale or exchange occurred immediately before such cessation and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year for which such income or gain is taken into account.

(d) Treatment of related person factoring income. --

(1) In general. -- For purposes of the provisions set forth in paragraph (2), if any person acquires (directly or indirectly) a trade or service receivable from a related person, any income of such person from the trade or service receivable so acquired shall be treated as if it were interest on a loan to the obligor under the receivable.

(2) Provisions to which paragraph (1) applies. -- The provisions set forth in this paragraph are as follows:

(A) Part III of subchapter G of this chapter (relating to foreign personal holding companies).

(B) Section 904 (relating to limitation on foreign tax credit).

(C) Subpart F of part III of this subchapter (relating to controlled foreign corporations).

(3) Trade or service receivable. -- For purposes of this subsection, the term "trade or service receivable" means any account receivable or evidence of indebtedness arising out of --

(A) the disposition by a related person of property described in section 1221(1), or

(B) the performance of services by a related person.

(4) Related person. -- For purposes of this subsection, the term "related person" means --

(A) any person who is a related person (within the meaning of section 267(b)), and

(B) any United States shareholder (as defined in section 951(b)) and any person who is a related person (within the meaning of section 267(b)) to such a shareholder.

(5) Certain provisions not to apply. --

(A) Certain exceptions. -- The following provisions shall not apply to any amount treated as interest under paragraph (1) or (6):

(i) Subparagraphs (A)(iii)(II), and (C)(iii)(III) of section 904(d)(2) (relating to exceptions for export financing interest).

(ii) Subparagraph (A) of section 954(b)(3) (relating to exception where foreign base company income is less than 5 percent or \$1,000,000).

(iii) Subparagraph (B) of section 954(c)(2) (relating to certain export financing).

(iv) Clause (i) of section 954(c)(3)(A) (relating to certain income received from related persons).

(B) Special rules for possessions. -- An amount treated as interest under paragraph (1) shall not be treated as income described in subparagraph (A) or (B) of section 936(a)(1) unless such amount is from sources within a possession of the United States (determined after the application of paragraph (1)).

(6) Special rule for certain income from loans of a controlled foreign corporation. -- Any income of a controlled foreign (within the meaning of section 957(a)) from a loan to a person for the purpose of financing --

(A) the purchase of property described in section 1221(1) of a related person, or

(B) the payment for the performance of services by a related person, shall be treated as interest described in paragraph (1).

(7) Exception for certain related persons doing business in same foreign country. -- Paragraph (1) shall not apply to any trade or service receivable acquired by any person from a related person if --

(A) the person acquiring such receivable and such related person are created or organized under the laws of the same foreign country and such related person has a substantial part of its assets used in its trade or business located in such same foreign country, and

(B) such related person would not have derived any foreign base company income (as defined in section 954(a), determined without regard to section 954(b)(3)(A)), or any income effectively connected with the conduct of a trade or business within the United States, from such receivable if it had been collected by such related person.

(8) Regulations. -- The Secretary shall prescribe such

regulations as may be necessary to prevent the avoidance of the provisions of this subsection or section 956(b)(3).

(e) Rules for allocating interest, etc. -- For purposes of this subchapter --

(1) Treatment of affiliated groups. -- The taxable income of each member of an affiliated group shall be determined by allocating and apportioning interest expense of each member as if all members of such group were a single corporation.

(2) Gross income method may not be used for interest. -- All allocations and apportionments of interests, expenses shall be made on the basis of assets rather than gross income.

(3) Tax-exempt assets not taken into account. -- For purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from such an asset) shall not be taken into account. A similar rule shall apply in the case of the portion of any dividend (other than a qualifying dividend as defined in section 243(b)) equal to the deduction allowable under section 243 or 245(a) with respect to such dividend and in the case of a like portion of any stock the dividends on which would be so deductible and would not be qualifying dividends (as so defined).

(4) Basis of stock in non affiliated 10-percent owned corporations adjusted for earnings and profits changes. --

(A) In general. -- for purposes of allocating and apportioning expenses on the basis of assets, the adjusted basis of any stock in a nonaffiliated 10-percent owned corporation shall be --

(i) increased by the amount of the earnings and profits of such corporation attributable to such stock and accumulated during the period the taxpayer held such stock, or

(ii) reduced (but not below zero) by and deficit in earnings and profits of such corporation attributable to such stock for such period.

(B) Nonaffiliated 10-percent owned corporation. -- For purposes of this paragraph, the term "nonaffiliated 10-percent owned corporation" means any corporation if --

(i) such corporation is not included in the taxpayer's affiliated group, and

(ii) members of such affiliated group own 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote.

(C) Earnings and profits of lower tier corporations taken into account. --

(i) In general. -- If, by reason of holding stock in a nonaffiliated 10-percent owned corporation, the taxpayer is treated under clause (iii) as owning stock in another corporation with respect to which the stock ownership requirements of clause (ii) are met, the adjustment under subparagraph (A) shall include an adjustment for the amount of the earnings and profits (or deficit therein) of such other corporation which are attributable to the stock the taxpayer is so treated as owning and to the period during which the taxpayer is treated as owning such stock.

(ii) Stock ownership requirements. -- The stock ownership requirements of this clause are met with respect to any corporation if members of the taxpayer's affiliated group own

(directly or through the application of clause (iii)) 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote.

(iii) Stock owned through entities. -- For purposes of this subparagraph, stock owned (directly or indirectly) by a corporation, partnership, or trust shall be treated as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence, shall, for purposes of applying such sentence, be treated as actually owned by such person.

(D) Coordination with subpart F, etc. -- For purposes of this paragraph, proper adjustment shall be made to the earnings and profits of any corporation to take into account any earnings and profits included in gross income under section 951 or under any other provision of this title and reflected in the adjusted basis of the stock.

(5) Affiliated group. -- For purposes of this subsection -

(A) In general. -- Except as provided in subparagraph (B), the term "affiliated group" has the meaning given such term by section 1504 (determined without regard to paragraph (4) of section 1504(b)).

(B) Treatment of certain financial institutions. -- For purposes of subparagraph (A), any corporation described in subparagraph (C) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying such section separately to corporations so described. This subparagraph shall not apply for purposes of paragraph (6).

(C) Description. -- A corporation is described in this subparagraph if --

(i) such corporation is a financial institution described in section 581 or 591,

(ii) the business of such financial institution is predominantly with persons other than related persons (within the meaning of subsection (d)(4)) or their customers, and

(iii) such financial institution is required by State or Federal law to be operate separately from any other entity which is not such an institution.

(D) Treatment of bank holding companies. -- To the extent provided in regulations --

(i) a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956), and

(ii) any subsidiary of a financial institution described in section 581 or 591 or of any bank holding company if such subsidiary is predominantly engaged (directly or indirectly) in the active conduct of a banking, financing, or similar business, shall be treated as a corporation described in subparagraph (C).

(6) Allocation and apportionment of other expenses. -- Expenses other than interest which are not directly allocable or apportioned to any specific income producing activity shall be allocated and apportioned as if all members of the affiliated group were a single corporation.

(7) Regulations. -- The Secretary shall prescribe such

regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing --

(A) for the resourcing of income of any member of an affiliated group or modifications to be consolidated return regulations to the extent such resourcing or modification is necessary to carry out the purposes of this section,

(B) for direct allocation of interest expenses incurred to carry out an integrated financial transaction to any interest (or interest-type income) derived from such transaction,

(C) for the apportionment of expenses allocated to foreign source income among the members of the affiliated group and various categories of income described in section 904(d)(1),

(D) for direct allocation of interest expense in the case of indebtedness resulting in a disallowance under section 246A,

(E) for appropriate adjustments in the application of paragraph (3) in the case of an insurance company, and

(F) that this subsection shall not apply for purposes of any provision of this subchapter to the extent the Secretary determines that the application of this subsection for such purposes would not be appropriate.

(f) Allocation of Research and Experimental Expenditures. -

(1) In general. For purposes of sections 861(b), 862(b), and 863(b), qualified research and experimental expenditures shall be allocated and apportioned as follows:

(A) Any qualified research and experimental expenditures expended solely to meet legal requirements imposed by a political entity with respect to the improvement of marketing of specific products or processes for purposes not reasonably expected to generate gross income (beyond de minimis amounts) outside the jurisdiction of the political entity shall be allocated only to gross income from sources within such jurisdiction.

(B) In the case of any qualified research and experimental expenditures (not allocated under subparagraph (1)) to the extent --

(i) that such expenditures are attributable to activities conducted in the United States, 64 percent of such expenditures shall be allocated and apportioned to income from sources within the United States and deducted from such income in determining the amount of taxable income from sources within the United States, and

(ii) that such expenditures are attributable to activities conducted outside the United States, 64 percent of such expenditures shall be allocated and apportioned to income from sources outside the United States and deducted from such income in determining the amount of taxable income from sources outside the United States.

(C) The remaining portion of qualified research and experimental expenditures (not allocated under subparagraphs (A) and (B)) shall be apportioned, at the annual election of the taxpayer, on the basis of gross sales or gross income, except that, if the taxpayer elects to apportion on the basis of gross income, the amount apportioned to income from sources outside the United States shall at least be 30 percent of the amount which would be so apportioned on the basis of gross sales.

(2) Qualified research and experimental expenditures. -- For purposes of this section, the term "qualified research and experimental expenditures" means amounts which are research and experimental expenditures within the meaning of section 174. For purposes of this paragraph, rules similar to the rules of subsection (c) of section 174 shall apply. Any qualified research and experimental expenditures treated as deferred expenses under subsection (b) of section 174 shall be taken into account under this subsection for the taxable year for which such expenditures are allowed as a deduction under such subsection.

(3) Special rules for expenditures attributable to activities conducted in space, etc. --

(A) In general. -- Any qualified research and experimental expenditures described in subparagraph (B) --

(i) if incurred by a United States person, shall be allocated and apportioned under this section in the same manner as if they were attributable to activities conducted in the United States, and

(ii) if incurred by a person other than a United States person, shall be allocated and apportioned under this section in the same manner as if they were attributable to activities conducted outside the United States.

(B) Description of expenditures. -- For purposes of subparagraph (A), qualified research and experimental expenditures are described in this subparagraph if such expenditures are attributable to activities conducted --

(i) in space,

(ii) on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States, or

(iii) in Antarctica.

(4) Affiliated group. --

(A) Except as provided in subparagraph (B), the allocation and apportionment required by paragraph (1) shall be determined as if all members of the affiliated group (as defined in subsection (e)(5)) were a single corporation.

(B) For purposes of the allocation and apportionment required by paragraph (1) --

(i) sales and gross income from product produced in whole or in part in a possession by an electing corporation (within the meaning of section 936(h)(5)(E)), and

(ii) dividends from an electing corporation.

shall not be taken into account, except that this subparagraph shall not apply to sale of (and gross income and dividends attributable to sale of) products with respect to which an election under section 936(h)(5)(F) is not in effect.

(C) The qualified research and experimental expenditures taken into account for purposes of paragraph (1) shall be adjusted to reflect the amount of such expenditures included in computing the cost-sharing amount (determined under section 936(h)(5)(C)(i)(I)).

(D) The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations providing for the source of gross income and all

allocation and apportionment of deductions to take into account the adjustments required by subparagraph (C).

(E) Paragraph (6) of subsection (e) shall not apply to qualified research and experimental expenditures.

(5) Years to which rule applies. --

(A) In general. -- This subsection shall apply to the taxpayer's first 3 taxable years beginning after August 1, 1989, and on or before August 1, 1992.

(B) Reduction. -- Notwithstanding subparagraph (A), in the case of the taxpayer's first taxable year beginning after August 1, 1991, this subsection shall only apply to qualified research and experimental expenditures incurred during the first 6 months of such taxable year.

865. Source rules for personal property sales

(a) General rule. -- Except as otherwise provided in this section, income from the sale of personal property --

(1) by a United States resident shall be sourced in the United States, or

(2) by a nonresident shall be sourced outside the United States.

(b) Exception for inventory property. -- In the case of income derived from the sale of inventory property --

(1) this section shall not apply, and

(2) such incomes shall be sourced under the rules of sections 861(a)(6), 862(a)(6), and 863(b).

(c) Exception for depreciable personal property. --

(1) In general. -- Gain (not in excess of the depreciation adjustments) from the sale of depreciable personal property shall be allocated between sources in the United States and sources outside the United States --

(A) by treating the same proportion of such gain as sourced in the United States as the United States depreciation adjustments with respect to such property bear to the total depreciation adjustments, and

(B) by treating the remaining portion of such gain as sourced outside the United States.

(2) Gain in excess of depreciation. -- Gain (in excess of the depreciation adjustments) from the sale of depreciable personal property shall be sourced as if such property were inventory property.

(3) United States depreciation adjustments. -- For purposes of this subsection --

(A) In general. -- The term "United States depreciation adjustments" means the portion of the depreciation adjustments to the adjusted basis of the property which are attributable to the depreciation deductions allowable in computing taxable income from sources in the United States.

(B) Special rule for certain property. -- Except in the case of property of a kind described in section 168(g)(4), if, for any taxable year --

(i) such property is used predominantly in the United States, or

(ii) such property is used predominantly outside the United States, all of the depreciation deductions allowable for such

year shall be treated as having been allocated to income from sources in the United States (or, where clause (ii) applies, from sources outside the United States).

(4) Other definitions. -- For purposes of this subsection

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(A) Depreciable personal property. -- The term "depreciable personal property" means any personal property if the adjusted basis of such property includes depreciation adjustments.

(B) Depreciation adjustments. -- The term "depreciation adjustments" means adjustments reflected in the adjusted basis of any property on account of depreciation deductions (whether allowed with respect to such property or other property and whether allowed to the taxpayer or to any other person).

(C) Depreciation deductions. -- The term "depreciation deductions" means any deductions for depreciation or amortization or any other deduction allowable under any provision of this chapter which treats an otherwise capital expenditure as a deductible expense.

(d) Exception for intangibles. --

(1) In general. -- In the cases of any sale of an intangible --

(A) this section shall apply only to the extent the payments in consideration of such sale are not contingent on the productivity, use, or disposition of the intangible, and

(B) to the extent such payments are so contingent, the source of such payments shall be determined under this part in the same manner as if such payments were royalties.

(2) Intangible. -- For purposes of paragraph (1), the term "intangible" means any patent, copyright, secret process or formula, goodwill, trademark, trade brand, franchise, or other like property.

(3) Special rule in the case of goodwill. -- To the extent this section applies to the sale of goodwill, payments in consideration of such sale shall be treated as from sources in the country in which such goodwill was generated.

(4) Coordination with subsection (c) --

(A) Gain not in excess of depreciation adjustments sourced under subsection (c). -- Notwithstanding paragraph (1), any gain from the sale of an intangible shall be sourced under subsection (c) to the extent such gain does not exceed the depreciation adjustments with respect to such intangible.

(B) Subsection (c)(2) not to apply to intangibles. -- Paragraph (2) of subsection (c) shall not apply to any gain from the sale of an intangible.

(e) Special rules for sales through offices or fixed places of business. --

(1) Sales by residents. --

(A) In general. -- In the case of income not sourced under subsection (b), (c), (d)(1)(B) or (3), or (f), if a United States resident maintains an office or other fixed place of business in a foreign county, income from sales of personal property attributable to such office or other fixed place of business shall be sourced outside the United States.

(B) Tax must be imposed. -- Subparagraph (A) shall not apply unless an income tax equal to at least 10 percent of the income from the sale is actually paid to a foreign country with respect to such income.

(2) Sales by nonresidents. --

(A) In general. -- Notwithstanding any other provisions of this part, if a nonresident maintains an office or other fixed place of business in the United States, income from any sale of person property (including inventory property) attributable to such office or other fixed place of business shall be sourced in the United States. The preceding sentence shall not apply for purposes of section 971 (defining export trade corporation).

(B) Exception. -- Subparagraph (A) shall not apply to any sale of inventory property which is sold for use, disposition, or consumption outside the United States if an office or other fixed place of business of the taxpayer in a foreign country materially participated in the sale.

(i) any sale of inventory property which is sold for use, disposition, or consumption outside the United States if an office or other fixed place of business of the taxpayer outside the United States materially participated in the sale, or

(ii) any amount included in gross income under section 951 (a)(1)(a).

(3) Sales attributable to an office or other fixed place of business. -- The principles of section 864(c)(5) shall apply in determining whether a taxpayer has an office or other fixed place of business and whether a sale is attributable to such an office or other fixed place of business.

(f) Stock of affiliates. If --

(1) a United States resident sells stock in an affiliate which is a foreign corporation,

(2) such sale occurs in a foreign country in which such affiliate is engaged in the active conduct of a trade or business, and

(3) more than 50 percent of the gross income of such affiliate for the 3-year period ending with the close of such affiliate's taxable year immediately preceding the year in which the sale occurred was derived from the active conduct of a trade or business in such foreign country.

any gain from such sale shall be sourced outside the United States. For purposes of paragraphs (2) and (3), the United States resident may elect to treat an affiliated and all other corporations which are wholly owned (directly or indirectly) by the affiliate as one corporation.

(g) United States resident; nonresident. -- For purposes of this section --

(1) In general. -- Except as otherwise provided in this subsection --

(A) United States resident. -- The term "United States resident" means --

(i) any individual who --

(I) is a United States citizen or a resident alien and does not have a tax home (as defined in section 911(d)(3)) in a foreign country, or

(II) is a nonresident alien and has a tax home (as so defined) in the United States, and

(ii) any corporation, trust, or estate which is a United States person (as defined in section 7701(1)(30)).

(B) Nonresident. -- The term "nonresident" means any person other than a United States resident.

(2) Special rules for United States citizens and resident aliens. -- For purposes of this section, a United States citizen or resident alien shall not be treated as a nonresident with respect to any sale of personal property unless an income tax equal to at least 10 percent of the gain derived from such sale is actually paid to a foreign country with respect to that gain.

(3) Special rule for certain stock sales by residents of Puerto Rico. --

Paragraph (2) shall not apply to the sale by an individual who was a bona fide resident of Puerto Rico during the entire taxable year of stock in a corporation if --

(A) such corporation is engaged in the active conduct of a trade or business in Puerto Rico, and

(B) more than 50 percent of its gross income for the 3-year period ending with the close of such corporation's taxable year immediately preceding the year in which such sale occurred was derived from the active conduct of a trade or business in Puerto Rico.

For purposes of the preceding sentence, the taxpayer may elect to treat a corporation and all other corporations which are wholly owned (directly or indirectly) by such corporation as one corporation.

(h) Treatment of gains from sale of certain stock or intangibles and from certain liquidations. --

(1) In general. -- In the case of gain to which this subsection applies --

(A) such gain shall be sourced outside the United States, but

(B) subsections (a), (b), and (c) of section 904 and section 902, 907, and 960 shall be applied separately with respect to such gain.

(2) Gain to which subsection applies. -- This subsection shall apply to --

(A) Gain from sale of certain stock or intangibles. -- Any gain --

(i) which is from the sale of stock in a foreign corporation or an intangible (as defined in subsection (d)(2)) and which would otherwise be sourced in the United States under this section,

(ii) which, under a treaty obligation of the United States (applied without regard to this section), would be sourced outside the United States, and

(iii) with respect to which the taxpayer chooses the benefits of this subsection.

(B) Gain from liquidation in possession. -- any gain which is derived from the receipt of any distribution in liquidation of a corporation --

(i) which is organized in a possession of the United States, and

(ii) more than 50 percent of the gross income of which during the 3-taxable year period ending with the close of the taxable year immediately preceding the taxable year in which the distribution is received is from the active conduct of a trade or business in such possession.

(i) Other definitions. -- For purposes of this section --

(1) Inventory property. -- The term "inventory property" means personal property described in paragraph (1) of section 1221.

(2) Sale includes exchange. -- The term "sale" includes an exchange or any other disposition.

(3) Treatment of possessions. -- Any possession of the United States shall be treated as a foreign country.

(4) Affiliate. -- The term "affiliate" means a member of the same affiliated group (within the meaning of section 1504(a) without regard to section 1504(b)).

(5) Treatment of partnerships. -- In the case of a partnership, except as provided in regulations, this section shall be applied at the partner level.

(j) Regulations. -- The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purpose of this section, including regulations --

(1) relating to the treatment of losses from sales of personal property,

(2) applying the rules of this section to income derived from trading in futures contracts, forward contracts, options contracts, and other instruments, and

(3) providing that, subject to such conditions (which may include provisions comparable to section 877) as may be provided in such regulation, subsections (e)(1)(B) and (g)(2) shall not apply for purposes of sections 931, 933, and 936.

(k) Cross references. --

(1) For provisions relating to the characterization as dividends for source purposes of gains from the sale of stock in certain foreign corporations, see section 1248.

(2) For sourcing of income from certain foreign currency transactions, see section 988.