Internal Revenue Code of 1986
SELECTED SECTIONS RELATING TO
International Aspects of U.S. Taxation
(2010)

EDITED BY
Michael J. McIntyre
Wayne State University Law School
Detroit, Michigan 48202
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Section 2.
Definitions and Special Rules

(d) Nonresident Aliens.— In the case of a nonresident alien individual, the taxes imposed by sections 1 and 55 shall apply only as provided by section 871 or 877.

Section 11.
Tax Imposed

(a) Corporations in General.— A tax is hereby imposed for each taxable year on the taxable income of every corporation.

(d) Foreign Corporations.— In the case of a foreign corporation, the taxes imposed by subsection (a) and section 55 shall apply only as provided by section 882.

Section 27.
Taxes of Foreign Countries and Possessions of the United States; Possession Tax Credit

(a) Foreign Tax Credit.— The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by this chapter to the extent provided in section 901.

Section 78.
Dividends Received from Certain Foreign Corporations by Domestic Corporations Choosing Foreign Tax Credit

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1) (relating to taxes paid by foreign corporation) for such taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation.

Section 152.
Dependent Defined

(b) Rules Relating to General Definition.— For purposes of this section—

(3) Citizens or nationals of other countries.—

(A) In general.— The term “dependent” does not include an individual who is not a citizen or national of the United States unless such individual is a resident of the United States or a country contiguous to the United States.

(B) Exception for adopted child.— Subparagraph (A) shall not exclude any child of a taxpayer (within the meaning of subsection (f)(1)(B)) from the definition of “dependent” if—

(i) for the taxable year of the taxpayer, the child has the same principal place of abode as the taxpayer and is a member of the taxpayer’s household, and

(ii) the taxpayer is a citizen or national of the United States.

Section 163.
Interest [Earnings Stripping]

(j) Limitation of Deduction for Interest on Certain Indebtedness.—

(1) Limitation.—

(A) In general.— If this subsection applies to any corporation for any taxable year, no deduction shall be allowed under this chapter for disqualified interest paid or accrued by such corporation during such taxable year. The amount disallowed under the preceding sentence shall not exceed the corporation’s excess interest expense for the taxable year.

(B) Disallowed amount carried to succeeding taxable year.— Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year (and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated).

(2) Corporations to which subsection applies.—

(A) In general.— This subsection shall apply to any corporation for any taxable year if—
(i) such corporation has excess interest expense for such taxable year, and

(ii) the ratio of debt to equity of such corporation as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5 to 1.

(B) Excess interest expense.—

(i) In general.— For purposes of this subsection, the term excess interest expense means the excess (if any) of:

(I) the corporation’s net interest expense, over

(II) the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward under clause ii).

(ii) Excess limitation carryforward.— If a corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the 1st succeeding taxable year and to the 2nd and 3rd succeeding taxable years to the extent not previously taken into account under this clause. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

(iii) Excess limitation.— For purposes of clause (i), the term “excess limitation” means the excess (if any) of:

(I) 50 percent of the adjusted taxable income of the corporation, over

(II) the corporation’s net interest expense.

(C) Ratio of debt to equity.— For purposes of this paragraph, the term “ratio of debt to equity” means the ratio which the total indebtedness of the corporation bears to the sum of its money and all other assets reduced (but not below zero) by such total indebtedness. For purposes of the preceding sentence—

(i) the amount taken into account with respect to any asset shall be the adjusted basis thereof for purposes of determining gain,

(ii) the amount taken into account with respect to any indebtedness with original issue discount shall be its issue price plus the portion of the original issue discount previously accrued as determined under the rules of section 1272 (determined without regard to subsection (a)(7) or (b)(4) thereof), and

(iii) there shall be such other adjustments as the Secretary may by regulations prescribe.

(3) Disqualified interest.— For purposes of this subsection, the term “disqualified interest” means—

(A) any interest paid or accrued by the taxpayer (directly or indirectly) to a related person if no tax is imposed by this subtitle with respect to such interest,

(B) any interest paid or accrued by the taxpayer with respect to any indebtedness to a person who is not a related person if—

(i) there is a disqualified guarantee of such indebtedness, and

(ii) no gross basis tax is imposed by this subtitle with respect to such interest, and

(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.

(4) Related person.— For purposes of this subsection—

(A) In general.— Except as provided in subparagraph (B), the term “related person” means any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

(B) Special rule for certain partnerships.—

(i) In general.— Any interest paid or accrued to a partnership which (without regard to this subparagraph) is a related person shall not be treated as paid or accrued to a related person if less than 10 percent of the profits and capital interests in such partnership are held by persons with respect to whom no tax is imposed by this subtitle on such interest. The preceding sentence shall not apply to any interest allocable to any partner in such partnership who is a related person to the taxpayer.

(ii) Special rule where treaty reduction.— If any treaty between the United States and any foreign country reduces the rate of tax imposed by this subtitle on a partner’s share of any interest paid or accrued to a partnership, such partner’s interests in such partnership shall, for purposes of clause (i), be treated as held in part by a tax-exempt person and in part by a taxable person under rules similar to the rules of paragraph (5)(B).

(5) Special rules for determining whether interest is subject to tax.—

(A) Treatment of pass-thru entities.— In the case of any interest paid or accrued to a partnership, the determination of whether any tax is imposed by this subtitle on such interest shall be made at the partner level. Rules similar to the rules of the preceding sentence shall apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.
(B) Interest treated as tax-exempt to extent of treaty reduction.— If any treaty between the United States and any foreign country reduces the rate of tax imposed by this subtitle on any interest paid or accrued by the taxpayer, such interest shall be treated as interest on which no tax is imposed by this subtitle to the extent of the same proportion of such interest as—

(i) the rate of tax imposed without regard to such treaty, reduced by the rate of tax imposed under the treaty, bears to

(ii) the rate of tax imposed without regard to the treaty.

(6) Other definitions and special rules.— For purposes of this subsection—

(A) Adjusted taxable income.— The term “adjusted taxable income” means the taxable income of the taxpayer—

(i) computed without regard to—

(I) any deduction allowable under this chapter for the net interest expense,

(II) the amount of any net operating loss deduction under section 172, and

(III) any deduction allowable for depreciation, amortization, or depletion, and

(ii) computed with such other adjustments as the Secretary may by regulations prescribe.

(B) Net interest expense.— The term “net interest expense” means the excess (if any) of—

(i) the interest paid or accrued by the taxpayer during the taxable year, over

(ii) the amount of interest includible in the gross income of such taxpayer for such taxable year.

The Secretary may by regulations provide for adjustments in determining the amount of net interest expense.

(C) Treatment of affiliated group.— All members of the same affiliated group (within the meaning of section 1504(a)) shall be treated as 1 taxpayer.

(D) Disqualified guarantee.—

(i) In general.— Except as provided in clause (ii), the term “disqualified guarantee” means any guarantee by a related person which is—

(I) an organization exempt from taxation under this subtitle, or

(II) a foreign person.

(ii) Exceptions.— The term “disqualified guarantee” shall not include a guarantee—

(I) in any circumstances identified by the Secretary by regulation, where the interest on the indebtedness would have been subject to a net basis tax if the interest had been paid to the guarantor, or

(II) if the taxpayer owns a controlling interest in the guarantor.

For purposes of subclause (II), except as provided in regulations, the term “a controlling interest” means direct or indirect ownership of at least 80 percent of the total voting power and value of all classes of stock of a corporation, or 80 percent of the profit and capital interests in any other entity. For purposes of the preceding sentence, the rules of paragraphs (1) and (5) of section 267(c) shall apply; except that such rules shall also apply to interest in entities other than corporations.

(iii) Guarantee.— Except as provided in regulations, the term “guarantee” includes any arrangement under which a person (directly or indirectly through an entity or otherwise) assures, on a conditional or unconditional basis, the payment of another person’s obligation under any indebtedness.

(E) Gross basis and net basis taxation.—

(i) Gross basis tax.— The term “gross basis tax” means any tax imposed by this subtitle which is determined by reference to the gross amount of any item of income without any reduction for any deduction allowed by this subtitle.

(ii) Net basis tax.— The term “net basis tax” means any tax imposed by this subtitle which is not a gross basis tax.

(7) Coordination with passive loss rules, etc.— This subsection shall be applied before sections 465 and 469.

(8) Treatment of Corporate Partners.— Except to the extent provided by regulations, in applying this subsection to a corporation which owns (directly or indirectly) an interest in a partnership—

(A) such corporation’s distributive share of interest income paid or accrued to such partnership shall be treated as interest income paid or accrued to such corporation,

(B) such corporation’s distributive share of interest paid or accrued by such partnership shall be treated as interest paid or accrued by such corporation, and

(C) such corporation’s share of the liabilities of such partnership shall be treated as liabilities of such corporation.

(8) Regulations.— The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including—

(A) such regulations as may be appropriate to prevent the avoidance of the purposes of this subsection,
(B) regulations providing such adjustments in the case of corporations which are members of an affiliated group as may be appropriate to carry out the purposes of this subsection, and
(C) regulations for the coordination of this subsection with section 884.

Section 269B.
Stapled Entities

(a) General Rule.— Except as otherwise provided by regulations, for purposes of this title—
(1) if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation shall be treated as a domestic corporation.
(2) in applying section 1563, stock in a second corporation which constitutes a stapled interest with respect to stock of a first corporation shall be treated as owned by such first corporation, and
(3) in applying subchapter M for purposes of determining whether any stapled entity is a regulated investment company or a real estate investment trust, all entities which are stapled entities with respect to each other shall be treated as 1 entity.

(b) Secretary to Prescribe Regulations.— The Secretary shall prescribe such regulations as may be necessary to prevent avoidance or evasion of Federal income tax through the use of stapled entities. Such regulations may include (but shall not be limited to) regulations providing the extent to which 1 of such entities shall be treated as owning the other entity (to the extent of the stapled interest) and regulations providing that any tax imposed on the foreign corporation referred to in subsection (a)(1) may, if not paid by such corporation, be collected from the domestic corporation referred to in such subsection or the shareholders of such foreign corporation.

(c) Definitions.— For purposes of this section—
(1) Entity.— The term “entity” means any corporation, partnership, trust, association, estate, or other form of carrying on a business or activity.
(2) Stapled entities.— The term “stapled entities” means any group of 2 or more entities if more than 50 percent in value of the beneficial ownership in each of such entities consists of stapled interests.
(3) Stapled interests.— Two or more interests are stapled interests if, by reason of form of ownership, restrictions on transfer, or other terms or conditions, in connection with the transfer of 1 of such interests the other such interests are also transferred or required to be transferred.

(d) Special Rule for Treaties.— Nothing in section 894 or 7852(d) or in any other provision of law shall be construed as permitting an exemption, by reason of any treaty obligation of the United States heretofore or hereafter entered into, from the provisions of this section.

(e) Subsection (a)(1) Not to Apply in Certain Cases.—
(1) In general.— Subsection (a)(1) shall not apply if it is established to the satisfaction of the Secretary that the domestic corporation and the foreign corporation referred to in such subsection are foreign owned.
(2) Foreign owned.— For purposes of paragraph (1), a corporation is foreign owned if less than 50 percent of—
(A) the total combined voting power of all classes of stock of such corporation entitled to vote, and
(B) the total value of the stock of the corporation, is held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30)).

Section 275.
Certain Taxes

(a) General Rule.— No deduction shall be allowed for the following taxes:
(1) Federal income taxes, including—
(A) the tax imposed by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act);
(B) the taxes imposed by sections 3201 and 3211 (relating to the taxes on railroad employees and railroad employee representatives); and
(C) the tax withheld at source on wages under section 3402.
(2) Federal war profits and excess profits taxes.
(3) Estate, inheritance, legacy, succession, and gift taxes.
(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States if the taxpayer chooses to take to any extent the benefits of section 901.
(5) Taxes on real property, to the extent that section 164(d) requires such taxes to be treated as imposed on another taxpayer.
(6) Taxes imposed by chapters 41, 42, 43, 44, 45, 46, and 54.
Paragraph (1) shall not apply to any taxes to the extent such taxes are allowable as a deduction under section 164(f).
Paragraph (1) shall not apply to the tax imposed by section 59A.

(b) Cross Reference.— For disallowance of certain other taxes, see section 164(c).

Section 312.
Effect on Earnings and Profits

* * *

(j) Earnings and Profits of Foreign Investment Companies.—

(1) Allocation within affiliated group.— In the case of a sale or exchange of stock in a foreign investment company (as defined in section 1246(b)) by a United States person (as defined in section 7701(a)(30)), if such company is a member of an affiliated group, then the accumulated earnings and profits of all members of such affiliated group shall be allocated, under regulations prescribed by the Secretary, in such manner as is proper to carry out the purposes of section 1246.

(2) Affiliated group defined.— For purposes of paragraph (1) of this subsection, the term “affiliated group” has the meaning assigned to such term by section 1504(a); except that (A) “more than 50 percent” shall be substituted for “80 percent or more”, and (B) all corporations shall be treated as includible corporations (without regard to the provisions of section 1504(b)).

(k) Effect of Depreciation on Earnings and Profits.—

(1) General rule.— For purposes of computing the earnings and profits of a corporation for any taxable year beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) shall be deemed to be the amount which would be allowable for such year if the straight line method of depreciation had been used for each taxable year beginning after June 30, 1972.

* * *

(4) Certain foreign corporations.— The provisions of paragraph (1) shall not apply in computing the earnings and profits of a foreign corporation for any taxable year for which less than 20 percent of the gross income from all sources of such corporation is derived from sources within the United States.

* * *

Section 318.
Constructive Ownership of Stock

(a) General Rule.— For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) Members of family.—

(A) In general.— An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) his children, grandchildren, and parents.

(B) Effect of adoption.— For purposes of subparagraph (A)(ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

(2) Attribution from partnerships, estates, trusts, and corporations.—

(A) From partnerships and estates.— Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) From trusts.—

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees’ trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) From corporations.— If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(3) Attribution to partnerships, estates, trusts, and corporations.—

(A) To partnerships and estates.— Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

(B) To trusts.—
(i) Stock owned, directly or indirectly, by or for a beneficiary of a trust (other than an employees’ trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary’s interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners), shall be considered as owned by the trust.

(C) To corporations.— If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) Options.— If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) Operating rules.—

(A) In general.— Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) Members of family.— Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) Partnerships, estates, trusts, and corporations.— Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) Option rule in lieu of family rule.— For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).

(E) S corporation treated as partnership.— For purposes of this subsection—

(i) an S corporation shall be treated as a partnership, and

(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person.

(b) Cross references.— For provisions to which the rules contained in subsection (a) apply, see—

(1) section 302 (relating to redemption of stock);

(2) section 304 (relating to redemption by related corporations);

(3) section 306(b)(1)(A) (relating to disposition of section 306 stock);

(4) section 338(h)(3) (defining purchase);

(5) section 382(l)(3) (relating to special limitations on net operating loss carryovers);

(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts);

(7) section 958(b) (relating to constructive ownership rules with respect to controlled foreign corporations); and

(8) section 6038(e)(1) (relating to information with respect to certain foreign corporations).

(d) Regulations.— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986, including—

(1) regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations and part III of this subchapter) or through the use of a regulated investment company, real estate investment trust, or tax-exempt entity, and

(2) regulations providing for appropriate coordination of the provisions of this section with the provisions of this title relating to taxation of foreign corporations and their shareholders.

Section 367.
Foreign Corporations

(a) Transfers of Property From the United States.—

(1) General rule.— If, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the
extent to which gain shall be recognized on such transfer, be
considered to be a corporation.

(2) Exception for certain stock or securities.– Except
to the extent provided in regulations, paragraph (1) shall not
apply to the transfer of stock or securities of a foreign
corporation which is a party to the exchange or a party to the
reorganization.

(3) Exception for transfers of certain property used
in the active conduct of a trade or business.–

(A) In general.– Except as provided in regulations
prescribed by the Secretary, paragraph (1) shall not apply
to any property transferred to a foreign corporation for use
by such foreign corporation in the active conduct of a trade
or business outside of the United States.

(B) Paragraph not to apply to certain property.–
Except as provided in regulations prescribed by the
Secretary, subparagraph (A) shall not apply to any—

(i) property described in paragraph (1) or
(ii) installment obligations, accounts receivable, or
similar property,
(iii) foreign currency or other property denominated
in foreign currency,
(iv) intangible property (within the meaning of sec-
tion 936(h)(3)(B)), or
(v) property with respect to which the transferor is a
lessor at the time of the transfer, except that this clause
shall not apply if the transferee was the lessee.

(C) Transfer of foreign branch with previously
deducted losses.– Except as provided in regulations prescribed by the Secretary, subparagraph (A) shall not apply to gain realized on the transfer of the assets of a foreign branch of a United States person to a foreign
corporation in an exchange described in paragraph (1) to
the extent that—

(i) the sum of losses—

(I) which were incurred by the foreign branch
before the transfer, and
(II) with respect to which a deduction was
allowed to the taxpayer, exceeds
(ii) the sum of—

(I) any taxable income of such branch for a taxable
year after the taxable year in which the loss was
incurred and through the close of the taxable year of
the transfer, and
(II) the amount which is recognized under section
904(f)(3) on account of the transfer.

Any gain recognized by reason of the preceding sentence
shall be treated for purposes of this chapter as income from
sources outside the United States having the same
character as such losses had.

(4) Special rule for transfer of partnership
interests.– Except as provided in regulations prescribed by
the Secretary, a transfer by a United States person of an
interest in a partnership to a foreign corporation in an ex-
change described in paragraph (1) shall, for purposes of this
subsection, be treated as a transfer to such corporation of
such person’s pro rata share of the assets of the partnership.

(5) Paragraphs (2) and (3) not to apply to certain
section 361 transactions.– Paragraphs (2) and (3) shall not
apply in the case of an exchange described in subsection (a)
or (b) of section 361. Subject to such basis adjustments and
such other conditions as shall be provided in regulations, the
preceding sentence shall not apply if the transferor
corporation is controlled (within the meaning of section
368(c)) by 5 or fewer domestic corporations. For purposes of
the preceding sentence, all members of the same affiliated
group (within the meaning of section 1504) shall be treated
as 1 corporation.

(6) Secretary may exempt certain transactions from
application of this subsection.– Paragraph (1) shall not
apply to the transfer of any property which the Secretary, in
order to carry out the purposes of this subsection, designates
by regulation.

(b) Other transfers.–

(1) Effect of section to be determined under regu-
lations.– In the case of any exchange described in section
332, 351, 354, 355, 356, or 361 in connection with which
there is no transfer of property described in subsection (a)(1),
a foreign corporation shall be considered to be a corporation
except to the extent provided in regulations prescribed by the
Secretary which are necessary or appropriate to prevent the
avoidance of Federal income taxes.

(2) Regulations relating to sale or exchange of
stock in foreign corporations.– The regulations pre-
scribed pursuant to paragraph (1) shall include (but shall not
be limited to) regulations dealing with the sale or exchange of
stock or securities in a foreign corporation by a United States
person, including regulations providing—

(A) the circumstances under which—

(i) gain shall be recognized currently, or amounts
included in gross income currently as a dividend, or
both, or
(ii) gain or other amounts may be deferred for in-
clusion in the gross income of a shareholder (or his
successor in interest) at a later date, and

(B) the extent to which adjustments shall be made to
earnings and profits, basis of stock or securities, and basis
of assets.
Selected International Sections

(c) Transactions to be Treated as Exchanges.—

(1) Section 355 distribution.— For purposes of this section, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

(2) Contribution of capital to controlled corporations.— For purposes of this chapter, any transfer of property to a foreign corporation as a contribution to the capital of such corporation by one or more persons who, immediately after the transfer, own (within the meaning of section 318) stock possessing at least 80 percent of the total combined voting power of all classes of stock of such corporation entitled to vote shall be treated as an exchange of such property for stock of the foreign corporation equal in value to the fair market value of the property transferred.

(d) Special Rules Relating to Transfers of Intangibles.—

(1) In general.— Except as provided in regulations prescribed by the Secretary, if a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or 361—

(A) subsection (a) shall not apply to the transfer of such property, and

(B) the provisions of this subsection shall apply to such transfer.

(2) Transfer of intangibles treated as transfer pursuant to sale of contingent payments.—

(A) In general.— If paragraph (1) applies to any transfer, the United States person transferring such property shall be treated as—

(i) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and

(ii) receiving amounts which reasonably reflect the amounts which would have been received—

(I) annually in the form of such payments over the useful life of such property, or

(II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.

The amounts taken into account under clause (ii) shall be commensurate with the income attributable to the intangible.

(B) Effect on earnings and profits.— For purposes of this chapter, the earnings and profits of a foreign corporation to which the intangible property was transferred shall be reduced by the amount required to be included in the income of the transferor of the intangible property under subparagraph (A)(ii).

(C) Amounts received treated as ordinary income.— For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income. For purposes of applying section 904(d), any such amount shall be treated in the same manner as if such amount were a royalty.

(e) Treatment of distributions described in section 355 or liquidations under section 332

(1) Distributions described in section 355.— In the case of any distribution described in section 355 (or so much of section 356 as relates to section 355) by a domestic corporation to a person who is not a United States person, to the extent provided in regulations, gain shall be recognized under principles similar to the principles of this section.

(2) Liquidations under section 332.— In the case of any liquidation to which section 332 applies, except as provided in regulations, subsections (a) and (b)(1) of section 337 shall not apply where the 80-percent distributee (as defined in section 337(c)) is a foreign corporation.

(f) Other Transfers.— To the extent provided in regulations, if a United States person transfers property to a foreign corporation as paid-in surplus or as a contribution to capital (in a transaction not otherwise described in this section), such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

(1) the fair market value of the property so transferred, over

(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

Section 482.
Allocation of Income and Deductions Among Taxpayers

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or
license shall be commensurate with the income attributable to the intangible.

Subchapter I—Natural Resources
Part V—Continental Shelf Areas

Section 638.
Continental Shelf Areas

For purposes of applying the provisions of this chapter (including sections 861(a)(3) and 862(a)(3) in the case of the performance of personal services) with respect to mines, oil and gas wells, and other natural deposits—

(1) the term “United States” when used in a geographical sense includes the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources; and

(2) the terms “foreign country” and “possession of the United States” when used in a geographical sense include the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the foreign country or such possession and over which the foreign country (or the United States in case of such possession) has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources, but this paragraph shall apply in the case of a foreign country only if it exercises, directly or indirectly, taxing jurisdiction with respect to such exploration or exploitation.

No foreign country shall, by reason of the application of this section, be treated as a country contiguous to the United States.

Subchapter J—Estates, Trusts, Beneficiaries and Decedents
[§§ 641—679]

Section 679.
Foreign Trusts Having One or More United States Beneficiaries

(a) Transferor Treated as Owner.—

(1) In general.— A United States person who directly or indirectly transfers property to a foreign trust (other than a trust described in section 6048(a)(3)(B)(ii)) shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.

(2) Exceptions.— Paragraph (1) shall not apply—

(A) Transfers by reason of death.— To any transfer by reason of the death of the transferor.

(B) Transfers at fair market value.— To any transfer of property to a trust in exchange for consideration of at least the fair market value of the transferred property. For purposes of the preceding sentence, consideration other than cash shall be taken into account at its fair market value.

(3) Certain obligations not taken into account under fair market value exception.—

(A) In general.— In determining whether paragraph (2)(B) applies to any transfer by a person described in clause (ii) or (iii) of subparagraph (C), there shall not be taken into account—

(i) except as provided in regulations, any obligation of a person described in subparagraph (C), and

(ii) to the extent provided in regulations, any obligation which is guaranteed by a person described in subparagraph (C).

(B) Treatment of principal payments on obligation.— Principal payments by the trust on any obligation referred to in subparagraph (A) shall be taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

(C) Persons described.— The persons described in this subparagraph are—

(i) the trust,

(ii) any grantor, owner, or beneficiary of the trust, and

(iii) any person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, owner, or beneficiary of the trust.

(4) Special rules applicable to foreign grantor who later becomes a United States person.—

(A) In general.— If a nonresident alien individual has a residency starting date within 5 years after directly or indirectly transferring property to a foreign trust, this section and section 6048 shall be applied as if such individual transferred to such trust on the residency starting date an amount equal to the portion of such trust attributable to the property transferred by such individual to such trust in such transfer.

(B) Treatment of undistributed income.— For purposes of this section, undistributed net income for periods before such individual’s residency starting date shall be taken into account in determining the portion of the trust which is attributable to property transferred by such individual to such trust but shall not otherwise be taken into account.
(C) **Residency starting date.**— For purposes of this paragraph, an individual’s residency starting date is the residency starting date determined under section 7701(b)(2)(A).

(5) **Outbound trust migrations.**— If—

United States transferred property to a trust which was not a foreign trust, and

(B) such trust becomes a foreign trust while such individual is alive, then this section and section 6048 shall be applied as if such individual transferred to such trust on the date such trust becomes a foreign trust an amount equal to the portion of such trust attributable to the property previously transferred by such individual to such trust. A rule similar to the rule of paragraph (4)(B) shall apply for purposes of this paragraph.

(b) **Trusts Acquiring United States Beneficiaries.**— If—

(1) subsection (a) applies to a trust for the transferor’s taxable year, and

(2) subsection (a) would have applied to the trust for his immediately preceding taxable year but for the fact that for such preceding taxable year there was no United States beneficiary for any portion of the trust, then, for purposes of this subtitle, the transferor shall be treated as having income for the taxable year (in addition to his other income for such year) equal to the undistributed net income (at the close of such immediately preceding taxable year) attributable to the portion of the trust referred to in subsection (a).

(c) **Trusts Treated as Having a United States Beneficiary.**—

(1) **In general.**— For purposes of this section, a trust shall be treated as having a United States beneficiary for the taxable year unless—

(A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a United States person, and

(B) if the trust were terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of a United States person.

(2) **Attribution of ownership.**— For purposes of paragraph (1), an amount shall be treated as paid or accumulated to or for the benefit of a United States person if such amount is paid to or accumulated for a foreign corporation, foreign partnership, or foreign trust or estate, and—

(A) in the case of a foreign corporation, such corporation is a controlled foreign corporation (as defined in section 957(a)),

(B) in the case of a foreign partnership, a United States person is a partner of such partnership, or

(C) in the case of a foreign trust or estate, such trust or estate has a United States beneficiary (within the meaning of paragraph (1)).

(3) **Certain United States beneficiaries disregarded.**— A beneficiary shall not be treated as a United States person in applying this section with respect to any transfer of property to foreign trust if such beneficiary first became a United States person more than 5 years after the date of such transfer.

(d) **Regulations.**— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

**Section 684. Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates**

(a) **In general.**— Except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust or to a nonresident alien, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

(1) the fair market value of the property so transferred, over

(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

(b) **Exceptions.**—

(1) **Transfers to certain trusts.**— Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any United States person is treated as the owner of such trust under section 671.

(2) **Lifetime transfers to nonresident aliens.**— Subsection (a) shall not apply to a lifetime transfer to a nonresident alien.

(c) **Treatment of Trusts Which Become Foreign Trusts.**— If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust.

IRC § 684
Section 861. Income from Sources Within the United States

(a) Gross Income from Sources Within United States.—The following items of gross income shall be treated as income from sources within the United States:

(1) Interest.—Interest from the United States or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of noncorporate residents or domestic corporations not including—

(A) interest from a resident alien individual or domestic corporation, if such individual or corporation meets the 80-percent foreign business requirements of subsection (c)(1),

(B) interest—

(i) on deposits with a foreign branch of a domestic corporation or a domestic partnership if such branch is engaged in the commercial banking business, and

(ii) on amounts satisfying the requirements of subparagraph (B) of section 871(i)(3) which are paid by a foreign branch of a domestic corporation or a domestic partnership, and

(C) in the case of a foreign partnership, which is predominantly engaged in the active conduct of a trade or business outside the United States, any interest not paid by a trade or business engaged in by the partnership in the United States and not allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.

(2) Dividends.—The amount received as dividends—

(A) from a domestic corporation other than a corporation which has an election in effect under section 936, or

(B) from a foreign corporation unless less than 25 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was effectively connected (or treated as effectively connected other than income described in section 884(d)(2)) with the conduct of a trade or business within the United States; but dividends (other than dividends for which a deduction is allowable under section 245(b)) from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (and only to the extent) exceeding the amount which is 100/70th of the amount of the deduction allowable under section 245 in respect of such dividends, or

(C) from a foreign corporation to the extent that such amount is required by section 243(e) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount, or

(D) from a DISC or former DISC (as defined in section 992(a)) except to the extent attributable (as determined under regulations prescribed by the Secretary) to qualified export receipts described in section 993(a)(1) (other than interest and gains described in section 995(b)(1)).

In the case of any dividend from a 20-percent owned corporation (as defined in section 243(c)(2)), subparagraph (B) shall be applied by substituting "100/80th" for "100/70th".

(3) Personal services.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

(A) the labor or services are performed 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,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with—

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

(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation.

In addition, compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if the labor or
services are performed by a nonresident alien individual in connection with the individual’s temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States.

(4) RENTALS AND ROYALTIES.— Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property.

(5) DISPOSITION OF UNITED STATES REAL PROPERTY INTEREST.— Gains, profits, and income from the disposition of a United States real property interest (as defined in section 897(c)).

(6) SALE OR EXCHANGE OF INVENTORY PROPERTY.— Gains, profits, and income derived from the purchase of inventory property (within the meaning of section 865(i)(1)) without the United States (other than within a possession of the United States) and its sale or exchange within the United States.

(7) Amounts received as underwriting income (as defined in section 832(b)(3)) derived from the issuing (or reinsuring) of any insurance or annuity contract—

(A) in connection with property in, liability arising out of an activity in, or in connection with the lives or health of residents of, the United States, or

(B) in connection with risks not described in subparagraph (A) as a result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect to issuing (or reinsuring) any insurance or annuity contract in connection with property in, liability arising out of activity in, or in connection with the lives or health of residents of, the United States.

(8) SOCIAL SECURITY BENEFITS.— Any social security benefit (as defined in section 86(d)).

(c) FOREIGN BUSINESS REQUIREMENTS.—

(1) FOREIGN BUSINESS REQUIREMENTS.—

(A) IN GENERAL.— An individual or corporation meets the 80-percent foreign business requirements of this paragraph if it is shown to the satisfaction of the Secretary that at least 80 percent of the gross income from all sources of such individual or corporation for the testing period is active foreign business income.

(B) ACTIVE FOREIGN BUSINESS INCOME.— For purposes of subparagraph (A), the term “active foreign business income” means gross income which—

(i) is derived from sources outside the United States (as determined under this subchapter) or, in the case of a corporation, is attributable to income so derived by a subsidiary of such corporation, and

(ii) is attributable to the active conduct of a trade or business in a foreign country or possession of the United States by the individual or corporation (or by a subsidiary.)

For purposes of this subparagraph, the term “subsidiary” means any corporation in which the corporation referred to in this subparagraph owns (directly or indirectly) stock meeting the requirements of section 1504(a)(2) (determined by substituting “50 percent” for “80 percent” each place it appears).

(C) TESTING PERIOD.— For purposes of this subsection, the term “testing period” means the 3-year period ending with the close of the taxable year of the individual or corporation preceding the payment (or such part of such period as may be applicable). If the individual or corporation has no gross income for such 3-year period (or part thereof), the testing period shall be the taxable year in which the payment is made.

(2) LOOK-THRU WHERE RELATED PERSON RECEIVES INTEREST.—

(A) IN GENERAL.— In the case of interest received by a related person from a resident alien individual or domestic corporation meeting the 80-percent foreign business requirements of paragraph (1), subsection (a)(1)(A) shall apply only to a percentage of such interest equal to the percentage which—

(i) the gross income of such individual or corporation for the testing period from sources outside the United States (as determined under this subchapter), is of

(ii) the total gross income of such individual or corporation for the testing period.

(B) RELATED PERSON.— For purposes of this paragraph, the term “related person” has the meaning given such term by section 954(d)(3), except that—
(i) such section shall be applied by substituting “the individual or corporation making the payment” for “controlled foreign corporation” each place it appears, and

(ii) such section shall be applied by substituting “10 percent or more” for “more than 50 percent” each place it appears.

(d) Special Rule for Application of Subsection (a)(2)(B).– For purposes of subsection (a)(2)(B), if the foreign corporation has no gross income from any source for the 3-year period (or part thereof) specified, the requirements of such subsection shall be applied with respect to the taxable year of such corporation in which the payment of the dividend is made.

(e) Income From Certain Railroad Rolling Stock Treated as Income from Sources Within the United States.–

(1) General rule.– For purposes of subsection (a) and section 862(a), if—

(A) a taxpayer leases railroad rolling stock which is section 1245 property (as defined in section 1245(a)(3)) to a domestic common carrier by railroad or a corporation which is controlled, directly or indirectly, by one or more such common carriers, and

(B) the use under such lease is expected to be use within the United States,

all amounts includible in gross income by the taxpayer with respect to such railroad rolling stock (including gain from sale or other disposition of such railroad rolling stock) shall be treated as income from sources within the United States. The requirements of subparagraph (B) of the preceding sentence shall be treated as satisfied if the only expected use outside the United States is use by a person (whether or not a United States person) in Canada or Mexico on a temporary basis which is not expected to exceed a total of 90 days in any taxable year.

(2) Paragraph (1) not to apply where lessor is a member of controlled group which includes a railroad.– Paragraph (1) shall not apply to a lease between two members of the same controlled group of corporations (as defined in section 1563) if any member of such group is a domestic common carrier by railroad or a switching or terminal company all of whose stock is owned by one or more domestic common carriers by railroad.

(3) Denial of foreign tax credit.– No credit shall be allowed under section 901 for any payments to foreign countries with respect to any amount received by the taxpayer with respect to railroad rolling stock which is subject to paragraph (1).

(f) Cross Reference.– For treatment of interest paid by the branch of a foreign corporation, see section 884(f).

Section 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 allocable 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.
Section 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, shall be treated as derived partly from sources within and partly from sources without 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.

In the case of transportation income derived from, or in connection with, a vessel, this subparagraph shall only apply if the taxpayer is a citizen or resident alien.

(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.

(c) 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 or 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.

Section 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.

(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 commod-
ities, 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 con-
nected 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 de-
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 con-
nected 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 indi-
vidual 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 from 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 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), (B)(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)).

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(6) Special rule for certain income from loans of a controlled foreign corporation.— Any income of a controlled foreign corporation (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 interest expense 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 nonaffiliated 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 any 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 operated 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 the 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 expense incurred to carry out an integrated financial transaction to any interest (or interest-type income) derived from such transaction and in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

(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,

(F) preventing assets or interest expense from being taken into account more than once, and

(G) 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) Election to Allocate Interest, Etc. on Worldwide Basis.—For purposes of this subchapter, at the election of the worldwide affiliated group—

(1) Allocation and Apportionment of Interest Expense.—

(A) In General.—The taxable income of each domestic corporation which is a member of a worldwide 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.

(B) Treatment of Worldwide Affiliated Group.—The taxable income of the domestic members of a worldwide affiliated group from sources outside the United States shall be determined by allocating and apportioning the interest expense of such domestic members to such income in an amount equal to the excess (if any) of—

(i) the total interest expense of the worldwide affiliated group multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to all the assets of the worldwide affiliated group, over

(ii) the interest expense of all foreign corporations which are members of the worldwide affiliated group to the extent such interest expense of such foreign corporations would have been allocated and apportioned to foreign source income if this subsection were
applied to a group consisting of all the foreign corporations in such worldwide affiliated group.

(C) **Worldwide Affiliated Group.**—For purposes of this paragraph, the term “worldwide affiliated group” means a group consisting of—

(i) the includible members of an affiliated group (as defined in section 1504(a), determined without regard to paragraphs (2) and (4) of section 1504(b)), and

(ii) all controlled foreign corporations in which such members in the aggregate meet the ownership requirements of section 1504(a)(2) either directly or indirectly through applying paragraph (2) of section 958(a) or through applying rules similar to the rules of such paragraph to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

(2) **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. For purposes of the preceding sentence, the term “affiliated group” has the meaning given such term by section 1504 (determined without regard to paragraph (4) of section 1504(b)).

(3) **Treatment of Tax-exempt Assets; Basis of Stock in Nonaffiliated 10-percent Owned Corporations.**—The rules of paragraphs (3) and (4) of subsection (e) shall apply for purposes of this subsection, except that paragraph (4) shall be applied on a worldwide affiliated group basis.

(4) **Treatment of Certain Financial Institutions.**—

(A) in General.—For purposes of paragraph (1), any corporation described in subparagraph (B) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying this subsection separately to corporations so described.

(B) 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 operated separately from any other entity which is not such an institution.

(C) **Treatment of Bank and Financial 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 (12 U.S.C. 1841(a)),

(ii) a financial holding company (within the meaning of section 2(p) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(p)), and

(iii) any subsidiary of a financial institution described in section 581 or 591, or of any such bank or financial 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 (B).

(5) **Election to Expand Financial Institution Group of Worldwide Group.**—

(A) in General.—If a worldwide affiliated group elects the application of this subsection, all financial corporations which—

(i) are members of such worldwide affiliated group, but

(ii) are not corporations described in paragraph (4)(B),

shall be treated as described in paragraph (4)(B) for purposes of applying paragraph (4)(A). This subsection (other than this paragraph) shall apply to any such group in the same manner as this subsection (other than this paragraph) applies to the pre-election worldwide affiliated group of which such group is a part.

(B) Financial Corporation.—For purposes of this paragraph, the term “financial corporation” means any corporation if at least 80 percent of its gross income is income described in section 904(d)(2)(D)(ii) and the regulations thereunder which is derived from transactions with persons who are not related (within the meaning of section 267(b) or 707(b)(1)) to the corporation. For purposes of the preceding sentence, there shall be disregarded any item of income or gain from a transaction or series of transactions a principal purpose of which is the qualification of any corporation as a financial corporation.

(C) **Anti-abuse Rules.**—In the case of a corporation which is a member of an electing financial institution group, to the extent that such corporation—

(i) distributes dividends or makes other distributions with respect to its stock after the date of the enactment of this paragraph to any member of the pre-election worldwide affiliated group (other than to a member of the electing financial institution group) in excess of the greater of—

(I) its average annual dividend (expressed as a percentage of current earnings and profits) during
the Taxable-year period ending with the taxable year preceding the taxable year, or

(II) 25 percent of its average annual earnings and profits for such 5-taxable-year period, or

(ii) deals with any person in any manner not clearly reflecting the income of the corporation (as determined under principles similar to the principles of section 482), an amount of indebtedness of the electing financial institution group equal to the excess distribution or the understatement or overstatement of income, as the case may be, shall be recharacterized (for the taxable year and subsequent taxable years) for purposes of this paragraph as indebtedness of the worldwide affiliated group (excluding the electing financial institution group). If a corporation has not been in existence for 5 taxable years, this subparagraph shall be applied with respect to the period it was in existence.

(D) Election.—An election under this paragraph with respect to any financial institution group may be made only by the common parent of the pre-election worldwide affiliated group and may be made only for the first taxable year beginning after December 31, 2017, in which such affiliated group includes 1 or more financial corporations. Such an election, once made, shall apply to all financial corporations which are members of the electing financial institution group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.

(E) Definitions Relating to Groups.—For purposes of this paragraph—

(i) Pre-election Worldwide Affiliated Group.—The term “pre-election worldwide affiliated group” means, with respect to a corporation, the worldwide affiliated group of which such corporation would (but for an election under this paragraph) be a member for purposes of applying paragraph (1).

(ii) Electing Financial Institution Group.—The term “electing financial institution group” means the group of corporations to which this subsection applies separately by reason of the application of paragraph (4)(A) and which includes financial corporations by reason of an election under subparagraph (A).

(F) Regulations.—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection, including regulations—

(i) providing for the direct allocation of interest expense in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

(ii) preventing assets or interest expense from being taken into account more than once, and

(iii) dealing with changes in members of any group (through acquisitions or otherwise) treated under this paragraph as an affiliated group for purposes of this subsection.

(6) Election.—An election to have this subsection apply with respect to any worldwide affiliated group may be made only by the common parent of the domestic affiliated group referred to in paragraph (1)(C) and may be made only for the first taxable year beginning after December 31, 2017, in which a worldwide affiliated group exists which includes such affiliated group and at least 1 foreign corporation. Such an election, once made, shall apply to such common parent and all other corporations which are members of such worldwide affiliated group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.

(7) [Ed. Deleted as of Dec. 31, 2010]

(g) 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 or 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 (A)) to the extent—

(i) that such expenditures are attributable to activities conducted in the United States, 50 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, 50 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 products produced in whole or in part in a possession by an electing corporation (within the meaning of section 936(b)(5)(E)), and

(ii) dividends from an electing corporation, shall not be taken into account, except that this subparagraph shall not apply to sales of (and gross income and dividends attributable to sales 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(b)(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 the allocation and apportionment of deductions to take into account the adjustments required by subparagraph (B) or (C).

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

(5) Regulations.– The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including regulations relating to the determination of whether any expenses are attributable to activities conducted in the United States or outside the United States and regulations providing such adjustments to the provisions of this subsection as may be appropriate in the case of cost-sharing arrangements and contract research.

(6) Applicability.– This subsection shall apply to the taxpayer’s first taxable year (beginning on or before August 1, 1994) following the taxpayer’s last taxable year to which Revenue Procedure 92-56 applies or would apply if the taxpayer elected the benefits of such Revenue Procedure.

Section 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 income shall be sourced under the rules of sections 861(a)(6), 862(a)(6), and 863.

Notwithstanding the preceding sentence, any income from the sale of any unprocessed timber which is a softwood and was cut from an area in the United States shall be sourced in the United

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States and the rules of sections 862(a)(6) and 863(b) shall not apply to any such income. For purposes of the preceding sentence, the term “unprocessed timber” means any log, cant, or similar form of timber.

(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—

(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 case 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 country, 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 personal property (including inventory proper-
ty) attributable to such office or other fixed place of busi-
ness 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.

(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 busi-
ness, 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 affiliate 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—

(1) 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(a)(30)).

(B) Nonresident.— The term “nonresident” means any
person other than a United States resident.

(2) Special rules for United States citizens and resi-
dent 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 subsec-
tion applies—

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

(B) subsections (a), (b), and (c) of section 904 and
sections 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 intangi-
bles.— Any gain—

(i) which is from the sale of stock in a foreign cor-
poration 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 regulations, 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.
(2) Capital gains of aliens present in the United States 183 days or more.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

(3) Taxation of social security benefits.—For purposes of this section and section 1441—

(A) 85 percent of any social security benefit (as defined in section 86(d)) shall be included in gross income (notwithstanding section 207 of the Social Security Act), and

(B) section 86 shall not apply.

For treatment of certain citizens of possessions of the United States, see section 932(c).

(b) Income Connected With United States Business.—

Graduated Rate of Tax—

(1) Imposition of tax.—A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 1 or 55, on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

(2) Determination of taxable income.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

(c) Participants in Certain Exchange or Training Programs.—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15)(F), (J), (M), or (Q)), shall be treated as a nonresident alien individual engaged in trade or business within the United States, and any income described in the second sentence of section 1441(b) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.

(d) Election to Treat Real Property Income as Income Connected With United States Business.—

(1) In general.—A nonresident alien individual who during the taxable year derives any income—

(A) from real property held for the production of income and located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of such real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631(b) or (c), and

(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States, may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary with respect to any taxable year.

(2) Election after revocation.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary consents to such new election.

(3) Form and time of election and revocation.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary may by regulations prescribe.

(e) [Repealed.]

(f) Certain Annuities Received Under Qualified Plans.—[Omitted.]
(g) Special Rules for Original Issue Discount.—

[Omitted.]

(h) Repeal of Tax on Interest of Nonresident Alien Individuals Received from Certain Portfolio Debt Investments.—

(1) In general.— In the case of any portfolio interest received by a nonresident individual from sources within the United States, no tax shall be imposed under paragraph (1)(A) or (1)(C) of subsection (a).

(2) Portfolio interest.— For purposes of this subsection, the term "portfolio interest" means any interest (including original issue discount) which would be subject to tax under subsection (a) but for this subsection and which is described in any of the following subparagraphs:

(A) Certain obligations which are not registered.— Interest which is paid on any obligation which—

(i) is not in registered form, and

(ii) is described in section 163(f)(2)(B).

(B) Certain registered obligations.— Interest which is paid on an obligation—

(i) which is in registered form, and

(ii) with respect to which the United States person who would otherwise be required to deduct and withhold tax from such interest under section 1441(a) receives a statement (which meets the requirements of paragraph (5)) that the beneficial owner of the obligation is not a United States person.

(3) Portfolio interest not to include interest received by 10-percent shareholders.— For purposes of this subsection—

(A) In general.— The term "portfolio interest" shall not include any interest described in subparagraph (A) or (B) of paragraph (2) which is received by a 10-percent shareholder.

(B) 10-Percent shareholder.— The term "10-percent shareholder" means—

(i) in the case of an obligation issued by a corporation, any person who owns 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote, or

(ii) in the case of an obligation issued by a partnership, any person who owns 10 percent or more of the capital or profits interest in such partnership.

(C) Attribution rules.— For purposes of determining ownership of stock under subparagraph (B)(i) the rules of section 318(a) shall apply, except—

(i) section 318(a)(2)(C) shall be applied without regard to the 50-percent limitation therein;

(ii) section 318(a)(3)(C) shall be applied—

(I) without regard to the 50-percent limitation therein; and

(II) in any case where such section would not apply but for subclause (I), by considering a corporation as owning the stock (other than stock in such corporation) which is owned by or for any shareholder of such corporation in that proportion which the value of the stock which such shareholder owns in such corporation bears to the value of all stock in such corporation, and

(iii) any stock which a person is treated as owning after application of section 318(a) shall not, for purposes of applying paragraphs (2) and (3) of section 318(a), be treated as actually owned by such person.

Under regulations prescribed by the Secretary, rules similar to the rules of the preceding sentence shall be applied in determining the ownership of the capital or profits interest in a partnership for purposes of subparagraph (B)(ii).

(4) Portfolio interest not to include certain contingent interest.— For purposes of this subsection—

(A) In general.— Except as otherwise provided in this paragraph, the term "portfolio interest" shall not include—

(i) any interest if the amount of such interest is determined by reference to—

(I) any receipts, sales or other cash flow of the debtor or related person,

(II) any income or profits of the debtor or a related person,

(III) any change in value of any property of the debtor or a related person, or

(IV) any dividend, partnership distributions, or similar payments made by the debtor or a related person, or

(ii) any other type of contingent interest that is identified by the Secretary by regulation, where a denial of the portfolio interest exemption is necessary or appropriate to prevent avoidance of Federal income tax.

(B) Related person.— The term "related person" means any person who is related to the debtor within the meaning of section 267(b) or 707(b)(1), or who is a party to any arrangement undertaken for a purpose of avoiding the application of this paragraph.

(C) Exceptions.— Subparagraph (A)(i) shall not apply to—

(i) any amount of interest solely by reason of the fact that the timing of any interest or principal payment is subject to a contingency,
(ii) any amount of interest solely by reason of the fact that the interest is paid with respect to nonrecourse or limited recourse indebtedness,

(iii) any amount of interest all or substantially all of which is determined by reference to any other amount of interest not described in subparagraph (A) (or by reference to the principal amount of indebtedness on which such other interest is paid),

(iv) any amount of interest solely by reason of the fact that the debtor or a related person enters into a hedging transaction to reduce the risk of interest rate or currency fluctuations with respect to such interest,

(v) any amount of interest determined by reference to—

(I) changes in the value of property (including stock) that is actively traded (within the meaning of section 1092(d)) other than property described in section 897(c)(1) or (g),

(II) the yield on property described in subclause (I), other than a debt instrument that pays interest described in subparagraph (A), or stock or other property that represents a beneficial interest in the debtor or a related person, or

(III) changes in any index of the value of property described in subclause (I) or of the yield on property described in subclause (II), and

(vi) any other type of interest identified by the Secretary by regulation.

(D) EXCEPTION FOR CERTAIN EXISTING INDEBTEDNESS.—Subparagraph (A) shall not apply to any interest paid or accrued with respect to any indebtedness with a fixed term—

(i) which was issued on or before April 7, 1993, or

(ii) which was issued after such date pursuant to a written binding contract in effect on such date and at all times thereafter before such indebtedness was issued.

(5) CERTAIN STATEMENTS.—A statement with respect to any obligation meets the requirements of this paragraph if such statement is made by—

(A) the beneficial owner of such obligation, or

(B) a securities clearing organization, a bank, or other financial institution that holds customers’ securities in the ordinary course of its trade or business.

The preceding sentence shall not apply to any statement with respect to payment of interest on any obligation by any person if, at least one month before such payment, the Secretary has published a determination that any statement from such person (or any class including such person) does not meet the requirements of this paragraph.

(6) SECRETARY MAY PROVIDE SUBSECTION NOT TO APPLY IN CASES OF INADEQUATE INFORMATION EXCHANGE.—

(A) IN GENERAL.—If the Secretary determines that the exchange of information between the United States and a foreign country is inadequate to prevent evasion of the United States income tax by United States persons, the Secretary may provide in writing (and publish a statement) that the provisions of this subsection shall not apply to payments of interest to any person within such foreign country (or payments addressed to, or for the account of, persons within such foreign country) during the period—

(i) beginning on the date specified by the Secretary, and

(ii) ending on the date that the Secretary determines that the exchange of information between the United States and the foreign country is adequate to prevent the evasion of United States income tax by United States persons.

(B) EXCEPTION FOR CERTAIN OBLIGATIONS.—Subparagraph (A) shall not apply to the payment of interest on any obligation which is issued on or before the date of the publication of the Secretary’s determination under such subparagraph.

(7) REGISTERED FORM.—For purposes of this subsection, the term “registered form” has the same meaning given such term by section 163(f).

(i) TAX NOT TO APPLY TO CERTAIN INTEREST AND DIVIDENDS.—

(1) IN GENERAL.—No tax shall be imposed under paragraph (1)(A) or (1)(C) of subsection (a) on any amount described in paragraph (2).

(2) AMOUNTS TO WHICH PARAGRAPH (1) APPLIES.—The amounts described in this paragraph are as follows:

(A) Interest on deposits, if such interest is not effectively connected with the conduct of a trade or business within the United States.

(B) A percentage of any dividend paid by a domestic corporation meeting the 80-percent foreign business requirements of section 861(c)(1) equal to the percentage determined for purposes of section 861(c)(2)(A).

(C) Income derived by a foreign central bank of issue from bankers’ acceptances.

(D) Dividends paid by a foreign corporation which are treated under section 861(a)(2)(B) as income from sources within the United States.

(3) DEPOSITS.—For purposes of paragraph (2), the term “deposits” means amounts which are—

(A) deposits with persons carrying on the banking business,
(B) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 (determined without regard to sections 265 and 291) in computing the taxable income of such institutions, and

(C) amounts held by an insurance company under an agreement to pay interest thereon.

(j) Exemption for Certain Gambling Winnings.—No tax shall be imposed under paragraph (1)(A) of subsection (a) on the proceeds from a wager placed in any of the following games: blackjack, baccarat, craps, roulette, or big-6 wheel. The preceding sentence shall not apply in any case where the Secretary determines by regulation that the collection of the tax is administratively feasible.

(k) Exemption for Certain Dividends of Regulated Investment Companies.—[Omitted.]

(l) Cross References.—

(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(e)(2).

(2) For taxation of nonresident alien individuals who are expatriate United States citizens, see section 877.

(3) For doubling of tax on citizens of certain foreign countries, see section 891.

(4) For adjustment of tax in case of nationals or residents of certain foreign countries, see section 896.

(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

(6) For election to treat married nonresident alien individual as resident of United States in certain cases, see subsections (g) and (h) of section 6013.

(7) For special tax treatment of gain or loss from the disposition by a nonresident alien individual of a United States real property interest, see section 897.

Section 872.
Gross Income

(a) General Rule.—In the case of a nonresident alien individual, except where the context clearly indicates otherwise, gross income includes only—

(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

(b) Exclusions.—The following items shall not be included in gross income of a nonresident alien individual, and shall be exempt from taxation under this subtitle:

(1) Ships operated by certain nonresidents.—Gross income derived by an individual resident of a foreign country from the international operation of a ship or ships if such foreign country grants an equivalent exemption to individual residents of the United States.

(2) Aircraft operated by certain nonresidents.—Gross income derived by an individual resident of a foreign country from the international operation of aircraft if such foreign country grants an equivalent exemption to individual residents of the United States.

(3) Compensation of participants in certain exchange or training programs.—Compensation paid by a foreign employer to a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J) or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended. For purposes of this paragraph, the term “foreign employer” means—

(A) a nonresident alien individual, foreign partnership, or foreign corporation, or

(B) an office or place of business maintained in a foreign country or in a possession of the United States by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States.

(4) Certain bond income of residents of the Ryukyu Islands or the Trust Territory of the Pacific Islands.—Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

(5) Income derived from wagering transactions in certain parimutuel pools.—Gross income derived by a nonresident alien individual from a legal wagering transaction initiated outside the United States in a parimutuel pool with respect to a live horse race or dog race in the United States.

(6) Certain rental income.—Income to which paragraphs (1) and (2) apply shall include income which is derived from the rental on a full or bareboat basis of a ship or ships or aircraft, as the case may be.

(7) Application to different types of transportation.—The Secretary may provide that this subsection be applied separately with respect to income from different types of transportation.
(8) Treatment of Possessions.– To the extent provided in regulations, a possession of the United States shall be treated as a foreign country for purposes of this subsection.

Section 873. Deductions

(a) General Rule.– In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary.

(b) Exceptions.– The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

(1) Losses.– The deduction allowed by section 165 for casualty or theft losses described in paragraph (2) or (3) of section 165(c), but only if the loss is of property located within the United States.

(2) Charitable contributions.– The deduction for charitable contributions and gifts allowed by section 170.

(3) Personal exemption.– The deduction for personal exemptions allowed by section 151, except that only one exemption shall be allowed under section 151 unless the taxpayer is a resident of a contiguous country or is a national of the United States.

(c) Cross Reference.– For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

Section 874. Allowance of Deductions and Credits

(a) Return Prerequisite to Allowance.– A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 33 for tax withheld at source or the credit provided by section 34 for certain uses of gasoline and special fuels.

(b) Tax Withheld at Source.– The benefit of the deduction for exemptions under section 151 may, in the discretion of the Secretary, and under regulations prescribed by the Secretary, be received by a non-resident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

(c) Foreign Tax Credit.– Except as provided in section 906, a nonresident alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

Section 875. Partnerships; Beneficiaries of Estates and Trusts

For purposes of this subtitle—

(1) a nonresident alien individual or foreign corporation shall be considered as being engaged in a trade or business within the United States if the partnership of which such individual or corporation is a member is so engaged, and

(2) a nonresident alien individual or foreign corporation which is a beneficiary of an estate or trust which is engaged in any trade or business within the United States shall be treated as being engaged in such trade or business within the United States.

Section 876. Alien Residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands

(a) General Rule.– This subpart shall not apply to any alien individual who is a bona fide resident of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands during the entire taxable year and such alien shall be subject to the tax imposed by section 1.

(b) Cross References.– For exclusion from gross income of income derived from sources within—

(1) Guam, American Samoa, and the Northern Mariana Islands, see section 931, and

(2) Puerto Rico, see section 933.

Section 877. Expatriation to Avoid Tax

(a) Treatment of Expatriates.–

(1) In general.– Every nonresident alien individual to whom this section applies and who, within the 10-year period immediately preceding the close of the taxable year, lost
United States citizenship shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection (after any reduction in such tax under the last sentence of such subsection) exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

(2) Individuals subject to this section.—This section shall apply to any individual if—

(A) the average annual net income tax (as defined in section 38(c)(1)) of such individual for the period of 5 taxable years ending before the date of the loss of United States citizenship is greater than $124,000,

(B) the net worth of the individual as of such date is $2,000,000 or more, or

(C) such individual fails to certify under penalty of perjury that he has met the requirements of this title for the 5 preceding taxable years or fails to submit such evidence of such compliance as the Secretary may require.

In the case of the loss of United States citizenship in any calendar year after 2004, such $124,000 amount shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “2003” for “1992” in subparagraph (B) thereof. Any increase under the preceding sentence shall be rounded to the nearest multiple of $1,000.

(b) Alternative tax.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1, or 55, except that—

(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (d) of this section), and

(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section. The tax imposed solely by reason of this section shall be reduced (but not below zero) by the amount of any income, war profits, and excess profits taxes (within the meaning of section 903 paid to any foreign country or possession of the United States on any income of the taxpayer on which tax is imposed solely by reason of this section.

(c) Exceptions.—

(1) In general.—Subparagraphs (A) and (B) of subsection (a)(2) shall not apply to an individual described in paragraph (2) or (3).

(2) Dual citizens.—

(A) In general.—An individual is described in this paragraph if—

(i) the individual became at birth a citizen of the United States and a citizen of another country and continues to be a citizen of such other country, and

(ii) the individual has had no substantial contacts with the United States.

(B) Substantial contacts.—An individual shall be treated as having no substantial contacts with the United States only if the individual—

(i) was never a resident of the United States (as defined in section 7701(b)),

(ii) has never held a United States passport, and

(iii) was not present in the United States for more than 30 days during any calendar year which is 1 of the 10 calendar years preceding the individual’s loss of United States citizenship.

(3) Certain minors.—An individual is described in this paragraph if—

(A) the individual became at birth a citizen of the United States,

(B) neither parent of such individual was a citizen of the United States at the time of such birth,

(C) the individual’s loss of United States citizenship occurs before such individual attains age 18 ½, and

(D) the individual was not present in the United States for more than 30 days during any calendar year which is 1 of the 10 calendar years preceding the individual’s loss of United States citizenship.

(d) Special rules for source, etc.—For purposes of subsection (b)—

(1) Source rules.—The following items of gross income shall be treated as income from sources within the United States:

(A) Sale of property.—Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

(B) Stock or debt obligations.—Gains on the sale or exchange of stock issued by a domestic corporation or debt...
obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

(C) Income or gain derived from controlled foreign corporation.—Any income or gain derived from stock in a foreign corporation but only—

(i) if the individual losing United States citizenship owned (within the meaning of section 958(a), or is considered as owning (by applying the ownership rules of section 958(b), at any time during the 2-year period ending on the date of the loss of United States citizenship more than 50 percent of—

(I) the total combined voting power of all classes of stock entitled to vote of such corporation, or

(II) the total value of the stock of such corporation, and

(ii) to the extent such income or gain does not exceed the earnings and profits attributable to such stock which were earned or accumulated before the loss of citizenship and during periods that the ownership requirements of clause (i) are met.

(2) Gain recognition on certain exchanges.—

(A) In general.—In the case of any exchange of property to which this paragraph applies, notwithstanding any other provision of this title, such property shall be treated as sold for its fair market value on the date of such exchange, and any gain shall be recognized for the taxable year which includes such date.

(B) Exchanges to which paragraph applies.—This paragraph shall apply to any exchange during the 10-year period beginning on the date the individual loses United States citizenship if—

(i) gain would not (but for this paragraph) be recognized on such exchange in whole or in part for purposes of this subtitle,

(ii) income derived from such property was from sources within the United States (or, if no income was so derived, would have been from such sources), and

(iii) income derived from the property acquired in the exchange would be from sources outside the United States.

(C) Exception.—Subparagraph (A) shall not apply if the individual enters into an agreement with the Secretary which specifies that any income or gain derived from the property acquired in the exchange (or any other property which has a basis determined in whole or part by reference to such property) during such 10-year period shall be treated as from sources within the United States. If the property transferred in the exchange is disposed of by the person acquiring such property, such agreement shall terminate and any gain which was not recognized by reason of such agreement shall be recognized as of the date of such disposition.

(D) Secretary may extend period.—To the extent provided in regulations prescribed by the Secretary, subparagraph (B) shall be applied by substituting the 15-year period beginning 5 years before the loss of United States citizenship for the 10-year period referred to therein. In the case of any exchange occurring during such 5 years, any gain recognized under this subparagraph shall be recognized immediately after such loss of citizenship.

(E) Secretary may require recognition of gain in certain cases.—To the extent provided in regulations prescribed by the Secretary—

(i) the removal of appreciated tangible personal property from the United States, and

(ii) any other occurrence which (without recognition of gain) results in a change in the source of the income or gain from property from sources within the United States to sources outside the United States,

shall be treated as an exchange to which this paragraph applies.

(3) Substantial diminishing of risks of ownership.—For purposes of determining whether this section applies to any gain on the sale or exchange of any property the running of the 10-year period described in subsection (a) and the period applicable under paragraph (2) shall be suspended for any period during which the individual’s risk of loss with respect to the property is substantially diminished by—

(A) the holding of a put with respect to such property (or similar property),

(B) the holding by another person of a right to acquire the property, or

(C) a short sale or any other transaction.

(4) Treatment of property contributed to controlled foreign corporations

(A) In general.—If—

(i) an individual losing United States citizenship contributes property during the 10-year period beginning on the date the individual loses United States citizenship to any corporation which, at the time of the contribution, is described in subparagraph (B), and

(ii) income derived from such property immediately before such contribution was from sources within the United States (or, if no income was so derived, would have been from such sources),

any income or gain on such property (or any other property which has a basis determined in whole or part by reference to such property) received or accrued by the corporation shall be treated as received or accrued directly by such individual and not by such corporation. The preceding
sentence shall not apply to the extent the property has been treated under subparagraph (C) as having been sold
by such corporation.

(B) Corporation described.—A corporation is described in this subparagraph with respect to an individual if, were such individual a United States citizen—

(i) such corporation would be a controlled foreign corporation (as defined in 957), and

(ii) such individual would be a United States shareholder (as defined in section 951(b) with respect to such corporation.

(C) Disposition of stock in corporation.—If stock in the corporation referred to in subparagraph (A) (or any other stock which has a basis determined in whole or part by reference to such stock) is disposed of during the 10-year period referred to in subsection (a) and while the property referred to in subparagraph (A) is held by such corporation, a pro rata share of such property (determined on the basis of the value of such stock) shall be treated as sold by the corporation immediately before such disposition.

(D) Anti-abuse rules.—The Secretary shall prescribe such regulations as may be necessary to prevent the avoidance of the purposes of this paragraph, including where—

(i) the property is sold to the corporation, and

(ii) the property taken into account under subparagraph (A) is sold by the corporation.

(E) Information reporting.—The Secretary shall require such information reporting as is necessary to carry out the purposes of this paragraph.

(c) Comparable treatment of lawful permanent residents who cease to be taxed as residents.—

(1) In general.—Any long-term resident of the United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)) shall be treated for purposes of this section and sections 2107, 2501, and 6039G in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.

(2) Long-term resident.—For purposes of this subsection, the term "long-term resident" means any individual (other than a citizen of the United States) who is a lawful permanent resident of the United States in at least 8 taxable years during the period of 15 taxable years ending with the taxable year during which the event described in subparagraph (A) or (B) of paragraph (1) occurs. For purposes of the preceding sentence, an individual shall not be treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country for the taxable year under the provisions of a tax treaty between the United States and the foreign country and does not waive the benefits of such treaty applicable to residents of the foreign country.

(3) Special rules.—

(A) Exceptions not to apply.—Subsection (c) shall not apply to an individual who is treated as provided in paragraph (1).

(B) Step-up in basis.—Solely for purposes of determining any tax imposed by reason of this subsection, property which was held by the long-term resident on the date the individual first became a resident of the United States shall be treated as having a basis on such date of not less than the fair market value of such property on such date. The preceding sentence shall not apply if the individual elects not to have such sentence apply. Such an election, once made, shall be irrevocable.

(C) Authority to exempt individuals.—This subsection shall not apply to an individual who is described in a category of individuals prescribed by regulation by the Secretary.

(D) Regulations.—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection, including regulations providing for the application of this subsection in cases where an alien individual becomes a resident of the United States during the 10-year period after being treated as provided in paragraph (1).

(E) Burden of proof.—If the Secretary establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual.

(f) Physical presence.—

(1) In general.—This section shall not apply to any individual to whom this section would otherwise apply for any taxable year during the 10-year period referred to in subsection (a) in which such individual is physically present in the United States at any time on more than 30 days in the calendar year ending in such taxable year, and such individual shall be treated for purposes of this title as a citizen or resident of the United States, as the case may be, for such taxable year.

(2) Exception.—

(A) In general.—In the case of an individual described in any of the following subparagraphs of this paragraph, a day of physical presence in the United States shall be

IRC § 877(g)
disregarded if the individual is performing services in the United States on such day for an employer. The preceding sentence shall not apply if—

(i) such employer is related (within the meaning of section 267 and 707) to such individual, or

(ii) such employer fails to meet such requirements as the Secretary may prescribe by regulations to prevent the avoidance of the purposes of this paragraph. Not more than 30 days during any calendar year may be disregarded under this subparagraph.

(B) INDIVIDUALS WITH TIES TO OTHER COUNTRIES.– An individual is described in this subparagraph if—

(i) the individual becomes (not later than the close of a reasonable period after loss of United States citizenship or termination of residency) a citizen or resident of the country in which—

(I) such individual was born,

(II) if such individual is married, such individual’s spouse was born, or

(III) either of such individual’s parents were born, and

(ii) the individual becomes fully liable for income tax in such country.

(C) MINIMAL PRIOR PHYSICAL PRESENCE IN THE UNITED STATES.– An individual is described in this subparagraph if, for each year in the 10-year period ending on the date of loss of United States citizenship or termination of residency, the individual was physically present in the United States for 30 days or less. The rule of section 7701(b)(3)(D) shall apply for purposes of this subparagraph.

(h) TERMINATION.– This section shall not apply to any individual whose expatriation date (as defined in section 877A(g)(3)) is on or after the date of the enactment of this subsection.

Section 877A
Tax Responsibilities of Expatriation

(a) GENERAL RULES.– For purposes of this subtitle—

(1) MARK TO MARKET.– All property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value.

(2) RECOGNITION OF GAIN OR LOSS.– In the case of any sale under paragraph (1)—

(A) notwithstanding any other provision of this title, any gain arising from such sale shall be taken into account for the taxable year of the sale, and

(B) any loss arising from such sale shall be taken into account for the taxable year of the sale to the extent otherwise provided by this title, except that section 1091 shall not apply to any such loss. Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence, determined without regard to paragraph (3).

(3) EXCLUSION FOR CERTAIN GAIN.–

(A) IN GENERAL.– The amount which would (but for this paragraph) be includible in the gross income of any individual by reason of paragraph (1) shall be reduced (but not below zero) by $600,000.

(B) ADJUSTMENT FOR INFLATION.–

(i) IN GENERAL.– In the case of any taxable year beginning in a calendar year after 2008, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting “calendar year 2007” for “calendar year 1992” in subparagraph (B) thereof.

(ii) Rounding.– If any amount as adjusted under clause (i) is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

(b) ELECTION TO DEFER TAX.–

(1) IN GENERAL.– If the taxpayer elects the application of this subsection with respect to any property treated as sold by reason of subsection (a), the time for payment of the additional tax attributable to such property shall be extended until the due date of the return for the taxable year in which such property is disposed of (or, in the case of property disposed of in a transaction in which gain is not recognized in whole or in part, until such other date as the Secretary may prescribe).

(2) DETERMINATION OF TAX WITH RESPECT TO PROPERTY.– For purposes of paragraph (1), the additional tax attributable to any property is an amount which bears the same ratio to the additional tax imposed by this chapter for the taxable year solely by reason of subsection (a) as the gain taken into account under subsection (a) with respect to such property bears to the total gain taken into account under subsection (a) with respect to all property to which subsection (a) applies.

(3) TERMINATION OF EXTENSION.– The due date for payment of tax may not be extended under this subsection later than the due date for the return of tax imposed by this chapter for the taxable year which includes the date of death.
of the expatriate (or, if earlier, the time that the security provided with respect to the property fails to meet the requirements of paragraph (4), unless the taxpayer corrects such failure within the time specified by the Secretary).

(4) Security.—

(A) In general.—No election may be made under paragraph (1) with respect to any property unless adequate security is provided with respect to such property.

(B) Adequate security.—For purposes of subparagraph (A), security with respect to any property shall be treated as adequate security if—

(i) it is a bond which is furnished to, and accepted by, the Secretary, which is conditioned on the payment of tax (and interest thereon), and which meets the requirements of section 6325, or

(ii) it is another form of security for such payment (including letters of credit) that meets such requirements as the Secretary may prescribe.

(5) Waiver of certain rights.—No election may be made under paragraph (1) unless the taxpayer makes an irrevocable waiver of any right under any treaty of the United States which would preclude assessment or collection of any tax imposed by reason of this section.

(6) Elections.—An election under paragraph (1) shall only apply to property described in the election and, once made, is irrevocable.

(7) Interest.—For purposes of section 6601, the last date for the payment of tax shall be determined without regard to the election under this subsection.

(c) Exception for certain property.—Subsection (a) shall not apply to—

(1) any deferred compensation item (as defined in subsection (d)(4)),

(2) any specified tax deferred account (as defined in subsection (e)(2)), and

(3) any interest in a nongrantor trust (as defined in subsection (f)(3)).

(d) Treatment of deferred compensation items.—

(1) Withholding on eligible deferred compensation items.—

(A) In general.—In the case of any eligible deferred compensation item, the payor shall deduct and withhold from any taxable payment to a covered expatriate with respect to such item a tax equal to 30 percent thereof.

(B) Taxable payment.—For purposes of subparagraph (A), the term “taxable payment” means with respect to a covered expatriate any payment to the extent it would be includible in the gross income of the covered expatriate if such expatriate continued to be subject to tax as a citizen or resident of the United States. A deferred compensation item shall be taken into account as a payment under the preceding sentence when such item would be so includible.

(2) Other deferred compensation items.—In the case of any deferred compensation item which is not an eligible deferred compensation item—

(A) (i) with respect to any deferred compensation item to which clause (ii) does not apply, an amount equal to the present value of the covered expatriate’s accrued benefit shall be treated as having been received by such individual on the day before the expatriation date as a distribution under the plan, and

(ii) with respect to any deferred compensation item referred to in paragraph (4)(D), the rights of the covered expatriate to such item shall be treated as becoming transferable and not subject to a substantial risk of forfeiture on the day before the expatriation date,

(B) no early distribution tax shall apply by reason of such treatment, and

(C) appropriate adjustments shall be made to subsequent distributions from the plan to reflect such treatment.

(3) Eligible deferred compensation items.—For purposes of this subsection, the term “eligible deferred compensation item” means any deferred compensation item with respect to which—

(A) the payor of such item is—

(i) a United States person, or

(ii) a person who is not a United States person but who elects to be treated as a United States person for purposes of paragraph (1) and meets such requirements as the Secretary may provide to ensure that the payor will meet the requirements of paragraph (1), and

(B) the covered expatriate—

(i) notifies the payor of his status as a covered expatriate, and

(ii) makes an irrevocable waiver of any right to claim any reduction under any treaty with the United States in withholding on such item.

(4) Deferred compensation item.—For purposes of this subsection, the term “deferred compensation item” means—

(A) any interest in a plan or arrangement described in section 219(g)(5),

(B) any interest in a foreign pension plan or similar retirement arrangement or program,

(C) any item of deferred compensation, and
(D) any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83.

(5) Exception.– Paragraphs (1) and (2) shall not apply to any deferred compensation item to the extent attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

(6) Special rules.–

(A) Application of withholding rules.– Rules similar to the rules of subchapter B of chapter 3 shall apply for purposes of this subsection.

(B) Application of tax.– Any item subject to the withholding tax imposed under paragraph (1) shall be subject to tax under section 871.

(C) Coordination with other withholding requirements.– Any item subject to withholding under paragraph (1) shall not be subject to withholding under section 1441 or chapter 24.

(e) Treatment of specified tax deferred accounts.–

(1) Account treated as distributed.– In the case of any interest in a specified tax deferred account held by a covered expatriate on the day before the expatriation date--

(A) the covered expatriate shall be treated as receiving a distribution of his entire interest in such account on the day before the expatriation date,

(B) no early distribution tax shall apply by reason of such treatment, and

(C) appropriate adjustments shall be made to subsequent distributions from the account to reflect such treatment.

(2) Specified tax deferred account.– For purposes of paragraph (1), the term “specified tax deferred account” means an individual retirement plan (as defined in section 7701(a)(37)) other than any arrangement described in subsection (k) or (p) of section 408, a qualified tuition program (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220).

(f) Special rules for nongrantor trusts.–

(1) In general.– In the case of a distribution (directly or indirectly) of any property from a nongrantor trust to a covered expatriate—

(A) the trustee shall deduct and withhold from such distribution an amount equal to 30 percent of the taxable portion of the distribution, and

(B) if the fair market value of such property exceeds its adjusted basis in the hands of the trust, gain shall be recognized to the trust as if such property were sold to the expatriate at its fair market value.

(2) Taxable portion.– For purposes of this subsection, the term “taxable portion” means, with respect to any distribution, that portion of the distribution which would be includible in the gross income of the covered expatriate if such expatriate continued to be subject to tax as a citizen or resident of the United States.

(3) Nongrantor trust.– For purposes of this subsection, the term “nongrantor trust” means the portion of any trust that the individual is not considered the owner of under subpart E of part I of subchapter J. The determination under the preceding sentence shall be made immediately before the expatriation date.

(4) Special rules relating to withholding.– For purposes of this subsection—

(A) rules similar to the rules of subsection (d)(6) shall apply, and

(B) the covered expatriate shall be treated as having waived any right to claim any reduction under any treaty with the United States in withholding on any distribution to which paragraph (1)(A) applies unless the covered expatriate agrees to such other treatment as the Secretary determines appropriate.

(5) Application.– This subsection shall apply to a nongrantor trust only if the covered expatriate was a beneficiary of the trust on the day before the expatriation date.

(g) Definitions and special rules relating to expatriation.– For purposes of this section—

(1) Covered expatriate.–

(A) In general.– The term “covered expatriate” means an expatriate who meets the requirements of subparagraph (A), (B), or (C) of section 877(a)(2).

(B) Exceptions.– An individual shall not be treated as meeting the requirements of subparagraph (A) or (B) of section 877(a)(2) if—

(i) the individual—

(1) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and

(II) has been a resident of the United States (as defined in section 7701(b)(1)(A)(ii)) for not more
than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs, or

(ii) (I) the individual’s relinquishment of United States citizenship occurs before such individual attains age 18\(\frac{1}{2}\), and

(II) the individual has been a resident of the United States (as so defined) for not more than 10 taxable years before the date of relinquishment.

(C) Covered expatriates also subject to tax as citizens or residents.— In the case of any covered expatriate who is subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, such individual shall not be treated as a covered expatriate during such period for purposes of subsections (d)(1) and (f) and section 2801.

(2) Expatriate.— The term “expatriate” means—

(A) any United States citizen who relinquishes his citizenship, and

(B) any long-term resident of the United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)).

(3) Expatriation date.— The term “expatriation date” means—

(A) the date an individual relinquishes United States citizenship, or

(B) in the case of a long-term resident of the United States, the date on which the individual ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)).

(4) Relinquishment of citizenship.— A citizen shall be treated as relinquishing his United States citizenship on the earliest of—

(A) the date the individual renounces his United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)),

(B) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)-(4)),

(C) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

(D) the date a court of the United States cancels a naturalized citizen’s certificate of naturalization.

Subparagraph (A) or (B) shall not apply to any individual unless the renunciation or voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State.

(5) Long-term resident.— The term “long-term resident” has the meaning given to such term by section 877(e)(2).

(6) Early distribution tax.— The term “early distribution tax” means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

(h) Other rules.—

(1) Termination of deferrals, etc.— In the case of any covered expatriate, notwithstanding any other provision of this title—

(A) any time period for acquiring property which would result in the reduction in the amount of gain recognized with respect to property disposed of by the taxpayer shall terminate on the day before the expatriation date, and

(B) any extension of time for payment of tax shall cease to apply on the day before the expatriation date and the unpaid portion of such tax shall be due and payable at the time and in the manner prescribed by the Secretary.

(2) Step-up in basis.— Solely for purposes of determining any tax imposed by reason of subsection (a), property which was held by an individual on the date the individual first became a resident of the United States (within the meaning of section 7701(b)) shall be treated as having a basis on such date of not less than the fair market value of such property on such date. The preceding sentence shall not apply if the individual elects not to have such sentence apply. Such an election, once made, shall be irrevocable.

(3) Coordination with section 684.— If the expatriation of any individual would result in the recognition of gain under section 684, this section shall be applied after the application of section 684.

(i) Regulations.— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

Section 879.
Tax Treatment of Certain Community Income in the Case of Nonresident Alien Individuals

(a) General Rule.— In the case of a married couple 1 or both of whom are nonresident alien individuals and who have community income for the taxable year, such community income shall be treated as follows:
(1) Earned income (within the meaning of section 911(d)(2)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services,

(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5),

(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable community property law) of one spouse shall be treated as the income of such spouse, and

(4) All other such community income shall be treated as provided in the applicable community property law.

(b) Exception Where Election Under Section 6013(g) Is in Effect.– Subsection (a) shall not apply for any taxable year for which an election under subsection (g) or (h) of section 6013 (relating to election to treat nonresident alien individual as resident of the United States) is in effect.

(c) Definitions and Special Rules.– For purposes of this section—

(1) Community income.—The term “community income” means income which, under applicable community property laws, is treated as community income.

(2) Community property laws.—The term “community property laws” means the community property laws of a State, a foreign country, or a possession of the United States.

(3) Determination of marital status.—The determination of marital status shall be made under section 7703(a).

Subpart B of Part II of Subchapter N—Foreign Corporations

Section 881. Tax on Income of Foreign Corporations Not Connected With United States Business

(a) Imposition of Tax.—Except as provided in subsection (c), there is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

(1) interest (other than original issue discount as defined in section 1273), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

(2) gains described in section 631(b) or (c),

(3) in the case of—

(A) a sale or exchange of an original issue discount obligation, the amount of the original issue discount accruing while such obligation was held by the foreign corporation (to the extent such discount was not theretofore taken into account under subparagraph (B)), and

(B) a payment on an original issue discount obligation, an amount equal to the original issue discount accruing while such obligation was held by the foreign corporation (except that such original issue discount shall be taken into account under this subparagraph only to the extent such discount was not theretofore taken into account under this subparagraph and only to the extent that the tax thereon does not exceed the payment less the tax imposed by paragraph (1) thereon), and

(4) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

(b) Exception for Certain Possessions.—

(1) Guam, American Samoa, the Northern Mariana Islands, and the Virgin Islands.—For purposes of this section and section 884, a corporation created or organized in Guam, American Samoa, the Northern Mariana Islands, or the Virgin Islands or under the law of any such possession shall not be treated as a foreign corporation for any taxable year if—

(A) at all times during such taxable year less than 25 percent in value of the stock of such corporation is beneficially owned (directly or indirectly) by foreign persons,

(B) at least 65 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to be effectively connected with the conduct of a trade or business in such a possession or the United States for the 3-year period ending with the close of the taxable year of such corporation (or for such part of such period as the corporation or any predecessor has been in existence), and

(C) no substantial part of the income of such corporation is used (directly or indirectly) to satisfy obligations to

IRC § 881(b)
persons who are not bona fide residents of such a possession or the United States.

(2) Commonwealth of Puerto Rico.—

(A) In general.— If dividends are received during a taxable year by a corporation—

(i) created or organized in, or under the law of, the Commonwealth of Puerto Rico, and

(ii) with respect to which the requirements of subparagraphs (A), (B), and (C) of paragraph (1) are met for the taxable year, subsection (a) shall be applied for such taxable year by substituting “10 percent” for “30 percent”.

(B) Applicability.— If, on or after the date of the enactment of this paragraph, an increase in the rate of the Commonwealth of Puerto Rico’s withholding tax which is generally applicable to dividends paid to United States corporations not engaged in a trade or business in the Commonwealth to a rate greater than 10 percent takes effect, this paragraph shall not apply to dividends received on or after the effective date of the increase.

(3) Definitions.—

(A) Foreign person.— For purposes of paragraph (1), the term “foreign person” means any person other than—

(i) a United States person, or

(ii) a person who would be a United States person if references to the United States in section 7701 included references to a possession of the United States.

(B) Indirect ownership rules.— For purposes of paragraph (1), the rules of section 318(a)(2) shall apply except that “5 percent” shall be substituted for “50 percent” in subparagraph (C) thereof.

(c) Repeal of Tax on Interest of Foreign Corporations Received from Certain Portfolio Debt Investments.—

(1) In general.— In the case of any portfolio interest received by a foreign corporation from sources within the United States, no tax shall be imposed under paragraph (1) or (3) of subsection (a).

(2) Portfolio interest.— For purposes of this subsection, the term “portfolio interest” means any interest (including original issue discount) which would be subject to tax under subsection (a) but for this subsection and which is described in any of the following subparagraphs:

(A) Certain obligations which are not registered.— Interest which is paid on any obligation which is described in section 871(h)(2)(A).

(B) Certain registered obligations.— Interest which is paid on an obligation—

(i) which is in registered form, and

(ii) with respect to which the person who would otherwise be required to deduct and withhold tax from such interest under section 1442(a) receives a statement which meets the requirements of section 871(h)(5) that the beneficial owner of the obligation is not a United States person.

(3) Portfolio interest shall not include interest received by certain persons.— For purposes of this subsection, the term “portfolio interest” shall not include any portfolio interest which—

(A) except in the case of interest paid on an obligation of the United States, is received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business,

(B) is received by a 10-percent shareholder (within the meaning of section 871(h)(3)(B)), or

(C) is received by a controlled foreign corporation from a related person (within the meaning of section 864(d)(4)).

(4) Portfolio interest not to include certain continent interest.— For purposes of this subsection, the term “portfolio interest” shall not include any interest which is treated as not being portfolio interest under the rules of section 871(h)(4).

(5) Special rules for controlled foreign corporations.—

(A) In general.— In the case of any portfolio interest received by a controlled foreign corporation, the following provisions shall not apply:

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

(ii) Paragraph (4) of section 954(b) (relating to exception for certain income subject to high foreign taxes).

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

(B) Controlled foreign corporation.— For purposes of this subsection, the term “controlled foreign corporation” has the meaning given to such term by section 957(a).

(6) Secretary may cease application of this subsection.— Under rules similar to the rules of section 871(h)(6), the Secretary may provide that this subsection shall not apply to payments of interest described in section 871(h)(6).

(7) Registered form.— For purposes of this subsection, the term “registered form” has the meaning given such term by section 163(f).
(d) Tax Not to Apply to Certain Interest and Dividends.— No tax shall be imposed under paragraph (1) or (3) of subsection (a) on any amount described in section 871(i)(2).

(e) Tax not to apply to certain dividends of regulated investment companies.—

(1) Interest-related dividends.— [Omitted.]

(f) Cross Reference.—
For doubling of tax on corporations of certain foreign countries, see section 891.
For special rules for original issue discount, see section 871(g).

Section 882.
Tax on Income of Foreign Corporations Connected With United States Business

(a) Imposition of Tax.—

(1) In general.— A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11, 55, 59A, or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

(2) Determination of taxable income.— In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

(3) [Cross reference].— For special tax treatment of gain or loss from the disposition by a foreign corporation of a United States real property interest, see section 897.

(b) Gross Income.— In the case of a foreign corporation, except where the context clearly indicates otherwise, gross income includes only—

(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

(c) Allowance of Deductions and Credits.—

(1) Allocation of deductions.—

(A) General rule.— In the case of a foreign corporation, the deductions shall be allowed only for purposes of subsection (a) and (except as provided by subparagraph (B)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary.

(B) Charitable contributions.— The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income which is effectively connected with the conduct of a trade or business within the United States.

(2) Deductions and credits allowed only if return filed.— A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary may deem necessary for the calculation of such deductions and credits. The preceding sentence shall not apply for purposes of the tax imposed by section 541 (relating to personal holding company tax), and shall not be construed to deny the credit provided by section 33 for tax withheld at source or the credit provided by section 34 for certain uses of gasoline.

(3) Foreign tax credit.— Except as provided by section 906, foreign corporations shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(4) Cross reference.— For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

(d) Election to Treat Real Property Income as Income Connected with United States Business.—

(1) In general.— A foreign corporation which during the taxable year derives any income—

(A) from real property located in the United States, or

from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631(b) or (c), and

(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States, may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that
it may be revoked with the consent of the Secretary with respect to any taxable year.

(2) Election after revocation, etc.– Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d).

(c) Interest on United States Obligations Received by Banks Organized in Possessions.– In the case of a corporation created or organized in, or under the law of, a possession of the United States which is carrying on the banking business in a possession of the United States, interest on obligations of the United States which is not portfolio interest (as defined in section 881(c)(2)) shall—

(1) for purposes of this subpart, be treated as income which is effectively connected with the conduct of a trade or business within the United States, and

(2) shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year.

(f) Returns of Tax by Agent.– If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent.

Section 883. Exclusions from Gross Income

(a) Income of Foreign Corporations from Ships and Aircraft.– The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) Ships operated by certain foreign corporations.– Gross income derived by a corporation organized in a foreign country from the international operation of a ship or ships if such foreign country grants an equivalent exemption to corporations organized in the United States.

(2) Aircraft operated by certain foreign corporations.– Gross income derived by a corporation organized in a foreign country from the international operation of aircraft if such foreign country grants an equivalent exemption to corporations organized in the United States.

(3) Railroad rolling stock of foreign corporations.– Earnings derived from payments by a common carrier for the use on a temporary basis (not expected to exceed a total of 90 days in any taxable year) of railroad rolling stock owned by a corporation of a foreign country which grants an equivalent exemption to corporations organized in the United States.

(4) Special rules.– The rules of paragraphs (6), (7) and (8) of section 872(b) shall apply for purposes of this subsection.

(5) Special rule for countries which tax on residence basis.– For purposes of this subsection, there shall not be taken into account any failure of a foreign country to grant an exemption to a corporation organized in the United States if such corporation is subject to tax by such foreign country on a residence basis pursuant to provisions of foreign law which meets such standards (if any) as the Secretary may prescribe.

(b) Earnings Derived from Communications Satellite System.– The earnings derived from the ownership or operation of a communications satellite system by a foreign entity designated by a foreign government to participate in such ownership or operation shall be exempt from taxation under this subtitle, if the United States, through its designated entity, participates in such system pursuant to the Communications Satellite Act of 1962 (47 U.S.C. 701 and following).

(c) Treatment of Certain Foreign Corporations.–

(1) In general.– Paragraph (1) or (2) of subsection (a) (as the case may be) shall not apply to any foreign corporation if 50 percent or more of the value of the stock of such corporation is owned by individuals who are not residents of such foreign country or another foreign country meeting the requirements of such paragraph.

(2) Treatment of controlled foreign corporations.– Paragraph (1) shall not apply to any foreign corporation which is a controlled foreign corporation (as defined in section 957(a)).

(3) Special rules for publicly traded corporations.–

(A) Exception.– Paragraph (1) shall not apply to any corporation which is organized in a foreign country meeting the requirements of paragraph (1) or (2) of subsection (a) (as the case may be) and the stock of which is primarily and regularly traded on an established securities market in such foreign country, another foreign country meeting the requirements of such paragraph, or the United States.

(B) Treatment of stock owned by publicly traded corporation.– Any stock in another corporation which is owned (directly or indirectly) by a corporation meeting the requirements of subparagraph (A) shall be treated as owned by individuals who are residents of the foreign country in which the corporation meeting the requirements of subparagraph (A) is organized.
(4) **Stock ownership through entities.**—For purposes of paragraph (1), stock owned (directly or indirectly) by or for a corporation, partnership, trust, or estate 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.

**Section 884. Branch Profits Tax**

(a) **Imposition of Tax.**—In addition to the tax imposed by section 882 for any taxable year, there is hereby imposed on any foreign corporation a tax equal to 30 percent of the dividend equivalent amount for the taxable year.

(b) **Dividend Equivalent Amount.**—For purposes of subsection (a), the term “dividend equivalent amount” means the foreign corporation’s effectively connected earnings and profits for the taxable year adjusted as provided in this subsection:

(1) **Reduction for increase in U.S. net equity.**—If—
(A) the U.S. net equity of the foreign corporation as of the close of the taxable year, exceeds
(B) the U.S. net equity of the foreign corporation as of the close of the preceding taxable year,
the effectively connected earnings and profits for the taxable year shall be reduced (but not below zero) by the amount of such excess.

(2) **Increase for decrease in net equity.**—
(A) **In general.**—If—
(i) the U.S. net equity of the foreign corporation as of the close of the taxable year, exceeds
(ii) the U.S. net equity of the foreign corporation as of the close of the preceding taxable year,
the effectively connected earnings and profits for the taxable year shall be increased by the amount of such excess.

(B) **Limitation.**—
(i) **In general.**—The increase under subparagraph (A) for any taxable year shall not exceed the accumulated effectively connected earnings and profits as of the close of the preceding taxable year.
(ii) **Accumulated effectively connected earnings and profits.**—For purposes of clause (i), the term “accumulated effectively connected earnings and profits” means the excess of—

(I) the aggregate effectively connected earnings and profits for preceding taxable years beginning after December 31, 1986, over

(II) the aggregate dividend equivalent amounts determined for such preceding taxable years.

(c) **U.S. Net Equity.**—For purposes of this section—

(1) **In general.**—The term “U.S. net equity” means—
(A) U.S. assets, reduced (including below zero) by
(B) U.S. liabilities.

(2) **U.S. assets and U.S. liabilities.**—For purposes of paragraph (1)—
(A) **U.S. assets.**—The term “U.S. assets” means the money and aggregate adjusted bases of property of the foreign corporation treated as connected with the conduct of a trade or business in the United States under regulations prescribed by the Secretary. For purposes of the preceding sentence, the adjusted basis of any property shall be its adjusted basis for purposes of computing earnings and profits.

(B) **U.S. liabilities.**—The term “U.S. liabilities” means the liabilities of the foreign corporation treated as connected with the conduct of a trade or business in the United States under regulations prescribed by the Secretary.

(C) **Regulations to be consistent with allocation of deductions.**—The regulations prescribed under sub-paragraphs (A) and (B) shall be consistent with the allocation of deductions under section 882(c)(1).

(d) **Effectively Connected Earnings and Profits.**—For purposes of this section—

(1) **In general.**—The term “effectively connected earnings and profits” means earnings and profits (without diminution by reason of any distributions made during the taxable year) which are attributable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

(2) **Exception for certain income.**—The term “effectively connected earnings and profits” shall not include any earnings and profits attributable to—

(A) income not includible in gross income under paragraph (1) or (2) of section 883(a),

(B) income treated as effectively connected with the conduct of a trade or business within the United States under section 921(d) or 926(b) (as in effect before their repeal by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000),
(C) gain on the disposition of a United States real property interest described in section 897(c)(1)(A)(ii),

(D) income treated as effectively connected with the conduct of a trade or business within the United States under section 953(c)(3)(C), or

(E) income treated as effectively connected with the conduct of a trade or business within the United States under section 882(e).

Property and liabilities of the foreign corporation treated as connected with such income under regulations prescribed by the Secretary shall not be taken into account in determining the U.S. assets or U.S. liabilities of the foreign corporation.

(e) Coordination with Income Tax Treaties; Etc.—

(1) Limitation on treaty exemption.— No treaty between the United States and a foreign country shall exempt any foreign corporation from the tax imposed by subsection (a) (or reduce the amount thereof) unless—

(A) such treaty is an income tax treaty, and

(B) such foreign corporation is a qualified resident of such foreign country.

(2) Treaty modifications.— If a foreign corporation is a qualified resident of a foreign country with which the United States has an income tax treaty—

(A) the rate of tax under subsection (a) shall be the rate of tax specified in such treaty—

(i) on branch profits if so specified, or

(ii) if not so specified, on dividends paid by a domestic corporation to a corporation resident in such country which wholly owns such domestic corporation, and

(B) any other limitations under such treaty on the tax imposed by subsection (a) shall apply.

(3) Coordination with withholding tax.—

(A) In general.— If a foreign corporation is subject to the tax imposed by subsection (a) for any taxable year (determined after the application of any treaty), no tax shall be imposed by section 871(a), 881(a), 1441, or 1442 on any dividends paid by such corporation out of its earnings and profits for such taxable year.

(B) Limitation on certain treaty benefits.— If—

(i) any dividend described in section 861(a)(2)(B) is received by a foreign corporation, and

(ii) subparagraph (A) does not apply to such dividend,

rules similar to the rules of subparagraphs (A) and (B) of subsection (f)(3) shall apply to such dividend.

(4) Qualified resident.— For purposes of this subsection—

(A) In general.— Except as otherwise provided in this paragraph, the term “qualified resident” means, with respect to any foreign country, any foreign corporation which is a resident of such foreign country unless—

(i) 50 percent or more (by value) of the stock of such foreign corporation is owned (within the meaning of section 883(c)(4)) by individuals who are not residents of such foreign country and who are not United States citizens or resident aliens, or

(ii) 50 percent or more of its income is used (directly or indirectly) to meet liabilities to persons who are not residents of such foreign country or citizens or residents of the United States.

(B) Special rule for publicly traded corporations.— A foreign corporation which is a resident of a foreign country shall be treated as a qualified resident of such foreign country if—

(i) the stock of such corporation is primarily and regularly traded on an established securities market in such foreign country, or

(ii) such corporation is wholly owned (either directly or indirectly) by another foreign corporation which is organized in such foreign country and the stock of which is so traded.

(C) Corporations owned by publicly traded domestic corporations.— A foreign corporation which is a resident of a foreign country shall be treated as a qualified resident of such foreign country if—

(i) such corporation is wholly owned (directly or indirectly) by a domestic corporation, and

(ii) the stock of such domestic corporation is primarily and regularly traded on an established securities market in the United States.

(D) Secretarial authority.— The Secretary may, in his sole discretion, treat a foreign corporation as being a qualified resident of a foreign country if such corporation establishes to the satisfaction of the Secretary that such corporation meets such requirements as the Secretary may establish to ensure that individuals who are not residents of such foreign country do not use the treaty between such foreign country and the United States in a manner inconsistent with the purposes of this subsection.

(5) Exception for international organizations.— This section shall not apply to an international organization (as defined in section 7701(a)(18)).

(f) Treatment of Interest Allocable to Effectively Connected Income.—

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(1) **In general.**— In the case of a foreign corporation engaged in a trade or business in the United States (or having gross income treated as effectively connected with the conduct of a trade or business in the United States), for purposes of this subtitle—

(A) any interest paid by such trade or business in the United States shall be treated as if it were paid by a domestic corporation, and

(B) to the extent that the allocable interest exceeds the interest described in subparagraph (A), such foreign corporation shall be liable for tax under section 881(a) in the same manner as if such excess were interest paid to such foreign corporation by a wholly owned domestic corporation on the last day of such foreign corporation's taxable year.

To the extent provided in regulations, subparagraph (A) shall not apply to interest in excess of the amounts reasonably expected to be allocable interest.

(2) **Allocable interest.**— For purposes of this subsection, the term "allocable interest" means any interest which is allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

(3) **Coordination with treaties.**—

(A) **Payor must be qualified resident.**— In the case of any interest described in paragraph (1) which is paid or accrued by a foreign corporation, no benefit under any treaty between the United States and the foreign country of which such corporation is a resident shall apply unless—

(i) such treaty is an income tax treaty, and

(ii) such foreign corporation is a qualified resident of such foreign country.

(B) **Recipient must be qualified resident.**— In the case of any interest described in paragraph (1) which is received or accrued by any corporation, no benefit under any treaty between the United States and the foreign country of which such corporation is a resident shall apply unless—

(i) such treaty is an income tax treaty, and

(ii) such foreign corporation is a qualified resident of such foreign country.

(g) **Regulations.**— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing for appropriate adjustments in the determination of the dividend equivalent amount in connection with the distribution to shareholders or transfer to a controlled corporation of the taxpayer's U.S. assets and other adjustments in such determination as are necessary or appropriate to carry out the purposes of this section.

**Section 885. Cross References**

(1) For special provisions relating to foreign corporations carrying on an insurance business within the United States, see section 842.

(2) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 864(b).

(3) For adjustment of tax in case of corporations of certain foreign countries, see section 896.

(4) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

(5) For withholding at source of tax on income of foreign corporations, see section 1442.

**Subpart C—Tax on Gross Transportation Income**

[§ 887]

**Section 887. Imposition of Tax on Gross Transportation Income of Nonresident Aliens and Foreign Corporations**

(a) **Imposition of Tax.**— In the case of any nonresident alien individual or foreign corporation, there is hereby imposed for each taxable year a tax equal to 4 percent of such individual’s or corporation’s United States source gross transportation income for such taxable year.

(b) **United States Source Gross Transportation Income.**—

(1) **In general.**— Except as provided in paragraph (2), the term “United States source gross transportation income” means any gross income which is transportation income (as defined in section 863(c)(3)) to the extent such income is treated as from sources in the United States under section 863(c)(2). To the extent provided in regulations, such term does not include any income of a kind to which an exemption under paragraph (1) or (2) of section 883(a) would not apply.

(2) **Exception for certain income effectively connected with business in the United States.**— The term “United States source gross transportation income” shall not include any income taxable under section 871(b) or 882.
(3) Exception for Certain Income Taxable in Possessions.—The term “United States source gross transportation income” does not include any income taxable in a possession of the United States under the provisions of this title as made applicable in such possession.

(4) Determination of Effectively Connected Income.—For purposes of this chapter, United States source gross transportation income of any taxpayer shall not be treated as effectively connected with the conduct of a trade or business in the United States unless—

(A) the taxpayer has a fixed place of business in the United States involved in the earning of United States source gross transportation income, and

(B) substantially all of the United States source gross transportation income (determined without regard to paragraph (2)) of the taxpayer is attributable to regularly scheduled transportation (or, in the case of income from the leasing of a vessel or aircraft, is attributable to a fixed place of business in the United States).

(c) Coordination with Other Provisions.—Any income taxable under this section shall not be taxable under section 871, 881, or 882.

Subpart D—Miscellaneous Provisions

Section 891. Doubling of Rates of Tax on Citizens and Corporations of Certain Foreign Countries

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 801, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

Section 892. Income of Foreign Governments and of International Organizations

(a) Foreign Governments.—

(1) In general.—The income of foreign governments received from—

(A) investments in the United States in—

(i) stocks, bonds, or other domestic securities owned by such foreign governments, or

(ii) financial instruments held in the execution of governmental financial or monetary policy, or

(B) interest on deposits in banks in the United States of moneys belonging to such foreign governments, shall not be included in gross income and shall be exempt from taxation under this subtitle.

(2) Income received directly or indirectly from commercial activities

(A) In general.—Paragraph (1) shall not apply to any income—

(i) derived from the conduct of any commercial activity (whether within or outside the United States),

(ii) received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or

(iii) derived from the disposition of any interest in a controlled commercial entity.

(B) Controlled commercial entity.—For purposes of subparagraph (A), the term “controlled commercial entity” means any entity engaged in commercial activities (whether within or outside the United States) if the government—

(i) holds (directly or indirectly) any interest in such entity which (by value or voting interest) is 50 percent or more of the total of such interests in such entity, or

(ii) holds (directly or indirectly) any other interest in such entity which provides the foreign government with effective control of such entity.

For purposes of the preceding sentence, a central bank of issue shall be treated as a controlled commercial entity only if engaged in commercial activities within the United States.
(3) **Treatment as Resident.**—For purposes of this title, a foreign government shall be treated as a corporate resident of its country. A foreign government shall be so treated for purposes of any income tax treaty obligation of the United States if such government grants equivalent treatment to the Government of the United States.

(b) **International Organizations.**—The income of international organizations received from investments in the United States in stocks, bonds, or other domestic securities owned by such international organizations, or from interest on deposits in banks in the United States of moneys belonging to such international organizations, or from any other source within the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

(c) **Regulations.**—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

**Section 893.**

**Compensation of Employees of Foreign Governments or International Organizations**

(a) **Rule for Exclusion.**—Wages, fees, or salary of any employee of a foreign government or of an international organization (including a consular or other officer, or a nondiplomatic representative), received as compensation for official services to such government or international organization shall not be included in gross income and shall be exempt from taxation under this subtitle if—

1. such employee is not a citizen of the United States, or is a citizen of the Republic of the Philippines (whether or not a citizen of the United States); and
2. in the case of an employee of a foreign government, the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and
3. in the case of an employee of a foreign government, the foreign government grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

(b) **Certificate by Secretary of State.**—The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries.

(c) **Limitation on Exclusion.**—Subsection (a) shall not apply to—

1. any employee of a controlled commercial entity (as defined in section 892(a)(2)(B)), or
2. any employee of a foreign government whose services are primarily in connection with a commercial activity (whether within or outside the United States) of the foreign government.

**Section 894.**

**Income Affected by Treaty**

(a) **Treaty Provisions.**—

1. **In general.**—The provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer.

2. **Cross reference.**—For relationship between treaties and this title, see section 7852(d).

(b) **Permanent Establishment in United States.**—For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b).

(c) **Denial of Treaty Benefits for Certain Payments Through Hybrid Entities.**—

1. **Application to certain payments.**—A foreign person shall not be entitled under any income tax treaty of the United States with a foreign country to any reduced rate of any withholding tax imposed by this title on an item of income derived through an entity which is treated as a partnership (or is otherwise treated as fiscally transparent) for purposes of this title if—

   (A) such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person,

   (B) the treaty does not contain a provision addressing the applicability of the treaty in the case of an item of income derived through a partnership, and

   (C) the foreign country does not impose tax on a distribution of such item of income from such entity to such person.

2. **Regulations.**—The Secretary shall prescribe such regulations as may be necessary or appropriate to determine
the extent to which a taxpayer to which paragraph (1) does not apply shall not be entitled to benefits under any income tax treaty of the United States with respect to any payment received by, or income attributable to any activities of, an entity organized in any jurisdiction (including the United States) that is treated as a partnership or is otherwise treated as fiscally transparent for purposes of this title (including a common investment trust under section 584, a grantor trust, or an entity that is disregarded for purposes of this title) and is treated as fiscally nontransparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

Section 895.
Income Derived by a Foreign Central Bank of Issue from Obligations of the United States or from Bank Deposits

Income derived by a foreign central bank of issue from obligations of the United States or of any agency or instrumentality thereof (including beneficial interests, participations, and other instruments issued under section 302(c) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717)) which are owned by such foreign central bank of issue, or derived from interest on deposits with persons carrying on the banking business, shall not be included in gross income and shall be exempt from taxation under this subtitle unless such obligations or deposits are held for, or used in connection with, the conduct of commercial banking functions or other commercial activities. For purposes of the preceding sentence the Bank for International Settlements shall be treated as a foreign central bank of issue.

Section 897.
Disposition of Investment in United States Real Property

(a) General Rule.—

(1) Treatment as effectively connected with United States trade or business.— For purposes of this title, gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a United States real property interest shall be taken into account—

(A) in the case of a nonresident alien individual, under section 871(b)(1), or

(B) in the case of a foreign corporation, under section 882(a)(1),

as if the taxpayer were engaged in a trade or business within the United States during the taxable year and as if such gain or loss were effectively connected with such trade or business.

(2) Minimum tax on nonresident alien individuals.— (A) In general.— In the case of any nonresident alien individual, the taxable excess for purposes of section 55(b)(1)(A) shall not be less than the lesser of—

(i) the individual’s alternative minimum taxable income (as defined in section 55(b)(2)) for the taxable year, or

(ii) the individual’s net United States real property gain for the taxable year.

(B) Net United States real property gain.— For purposes of subparagraph (A), the term “net United States real property gain” means the excess of—

(i) the aggregate of the gains for the taxable year from dispositions of United States real property interests, over

(ii) the aggregate of the losses for the taxable year from dispositions of such interests.

(b) Limitation on Losses of Individuals.— In the case of an individual, a loss shall be taken into account under subsection (a) only to the extent such loss would be taken into account under section 165(c) (determined without regard to subsection (a) of this section).

(c) United States Real Property Interest.— For purposes of this section—

(1) United States real property interest.— (A) In general.— Except as provided in subparagraph (B), the term “United States real property interest” means—

(i) an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands, and

(ii) any interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes (at such time and in such manner as the Secretary by regulations prescribes) that such corporation was at no time a United States real property holding corporation during the shorter of—

(I) the period after June 18, 1980, during which the taxpayer held such interest, or

(II) the 5-year period ending on the date of the disposition of such interest.

(B) Exclusion for interest in certain corporations.— The term “United States real property interest” does not include any interest in a corporation if—

(i) as of the date of the disposition of such interest, such corporation did not hold any United States real property interests, and
(ii) all of the United States real property interests held by such corporation at any time during the shorter of the periods described in subparagraph (A)(ii)—

(I) were disposed of in transactions in which the full amount of the gain (if any) was recognized, or

(II) ceased to be United States real property interests by reason of the application of this subparagraph to 1 or more other corporations.

(2) United States real property holding corporation.—The term “United States real property holding corporation” means any corporation if—

(A) the fair market value of its United States real property interests equals or exceeds 50 percent of

(B) the fair market value of—

(i) its United States real property interests,

(ii) its interests in real property located outside the United States, plus

(iii) any other of its assets which are used or held for use in a trade or business.

(3) Exception for stock regularly traded on established securities markets.—If any class of stock of a corporation is regularly traded on an established securities market, stock of such class shall be treated as a United States real property interest only in the case of a person who, at some time during the shorter of the periods described in paragraph (1)(A)(ii), held more than 5 percent of such class of stock.

(4) Interests held by foreign corporations and by partnerships, trusts, and estates.—For purposes of determining whether any corporation is a United States real property holding corporation—

(A) Foreign corporations.—Paragraph (1)(A)(ii) shall be applied by substituting “any corporation (whether foreign or domestic)” for “any domestic corporation”.

(B) Interests held by partnerships, etc.—Under regulations prescribed by the Secretary, assets held by a partnership, trust, or estate shall be treated as held proportionately by its partners or beneficiaries. Any asset treated as held by a partner or beneficiary by reason of this subparagraph which is used or held for use by the partnership, trust, or estate in a trade or business shall be treated as so used or held by the partner or beneficiary. Any asset treated as held by a partner or beneficiary by reason of this subparagraph shall be so treated for purposes of applying this subparagraph successively to partnerships, trusts, or estates which are above the first partnership, trust, or estate in a chain thereof.

(5) Treatment of controlling interests.—

(A) In general.—Under regulations, for purposes of determining whether any corporation is a United States real property holding corporation, if any corporation (hereinafter in this paragraph referred to as the “first corporation”) holds a controlling interest in a second corporation—

(i) the stock which the first corporation holds in the second corporation shall not be taken into account,

(ii) the first corporation shall be treated as holding a portion of each asset of the second corporation equal to the percentage of the fair market value of the stock of the second corporation represented by the stock held by the first corporation, and

(iii) any asset treated as held by the first corporation by reason of the application of clause (ii) which is used or held for use by the second corporation in a trade or business shall be treated as so used or held by the first corporation.

Any asset treated as held by the first corporation by reason of the preceding sentence shall be so treated for purposes of applying the preceding sentence successively to corporations which are above the first corporation in a chain of corporations.

(B) Controlling interest.—For purposes of subparagraph (A), the term “controlling interest” means 50 percent or more of the fair market value of all classes of stock of a corporation.

(6) Other special rules.—

(A) Interest in real property.—The term “interest in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

(B) Real property includes associated personal property.—The term “real property” includes movable walls, furnishings, and other personal property associated with the use of the real property.

(C) Constructive ownership rules.—For purposes of determining under paragraph (3) whether any person holds more than 5 percent of any class of stock and of determining under paragraph (5) whether a person holds a controlling interest in any corporation, section 318(a) shall apply (except that paragraphs (2)(C) and (3)(C) of section 318(a) shall be applied by substituting “5 percent” for “50 percent”).

(d) Treatment of Distributions by Foreign Corporations.—

(1) In general.—Except to the extent otherwise provided in regulations, notwithstanding any other provision of this chapter, gain shall be recognized by a foreign corporation on the distribution (including a distribution in liquidation or redemption) of a United States real property interest in an
(2) Exceptions.—Gain shall not be recognized under paragraph (1)—

(A) if—

(i) at the time of the receipt of the distributed property, the distributee would be subject to taxation under this chapter on a subsequent disposition of the distributed property, and

(ii) the basis of the distributed property in the hands of the distributee is no greater than the adjusted basis of such property before the distribution, increased by the amount of gain (if any) recognized by the distributing corporation, or

(B) if such nonrecognition is provided in regulations prescribed by the Secretary under subsection (e)(2).

(e) Coordination With Nonrecognition Provisions.—

(1) In general.—Except to the extent otherwise provided in subsection (d) and paragraph (2) of this subsection, any nonrecognition provision shall apply for purposes of this section to a transaction only in the case of an exchange of a United States real property interest for an interest the sale of which would be subject to taxation under this chapter.

(2) Regulations.—The Secretary shall prescribe regulations (which are necessary or appropriate to prevent the avoidance of Federal income taxes) providing—

(A) the extent to which nonrecognition provisions shall, and shall not, apply for purposes of this section, and

(B) the extent to which—

(i) transfers of property in reorganization, and

(ii) changes in interests in, or distributions from, a partnership, trust, or estate,

shall be treated as sales of property at fair market value.

(3) Nonrecognition provision defined.—For purposes of this subsection, the term “nonrecognition provision” means any provision of this title for not recognizing gain or loss.

(f) Repealed.—

(g) Special Rule for Sales of Interest in Partnerships, Trusts, and Estates.—Under regulations prescribed by the Secretary, the amount of any money, and the fair market value of any property, received by a nonresident alien individual or foreign corporation in exchange for all or part of its interest in a partnership, trust, or estate shall, to the extent attributable to United States real property interests, be considered as an amount received from the sale or exchange in the United States of such property.

(h) Special rules for certain investment entities.—For purposes of this section—

(1) Look-through of distributions.—Any distribution by a qualified investment entity to a nonresident alien individual, a foreign corporation, or other qualified investment entity shall, to the extent attributable to gain from sales or exchanges by the qualified investment entity of United States real property interests, be treated as gain recognized by such nonresident alien individual, foreign corporation, or other qualified investment entity from the sale or exchange of a United States real property interest. Notwithstanding the preceding sentence, any distribution by a qualified investment entity to a nonresident alien individual or a foreign corporation with respect to any class of stock which is regularly traded on an established securities market located in the United States shall not be treated as gain recognized from the sale or exchange of a United States real property interest if such individual or corporation did not own more than 5 percent of such class of stock at any time during the 1-year period ending on the date of such distribution.

(2) Sale of stock in domestically controlled entity not taxed.—The term “United States real property interest” does not include any interest in a domestically controlled qualified investment entity.

(3) Distributions by domestically controlled qualified investment entities.—In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.

(4) Definitions.—

(A) Qualified investment entity.—

(i) In general.—The term “qualified investment entity” means—

(I) any real estate investment trust, and

(II) any regulated investment company which is a United States real property holding corporation or which would be a United States real property holding corporation if the exceptions provided in subsections (c)(3) and (h)(2) did not apply to interests in any real estate investment trust or regulated investment company.

(ii) Termination.—Clause (i)(II) shall not apply after December 31, 2009.

Notwithstanding the preceding sentence, an entity described in clause (i)(II) shall be treated as a qualified investment entity for purposes of applying paragraphs (1)
(5) and section 1445 with respect to any distribution by the entity to a nonresident alien individual or a foreign corporation which is attributable directly or indirectly to a distribution to the entity from a real estate investment trust.

(B) Domestically controlled.— The term “domestically controlled qualified investment entity” means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.

(C) Foreign ownership percentage.— The term “foreign ownership percentage” means that percentage of the stock of the qualified investment entity which was held (directly or indirectly) by foreign persons at the time during the testing period during which the direct and indirect ownership of stock by foreign persons was greatest.

(D) Testing period.— The term “testing period” means whichever of the following periods is the shortest:

(i) the period beginning on June 19, 1980, and ending on the date of the disposition or of the distribution, as the case may be,

(ii) the 5-year period ending on the date of the disposition or of the distribution, as the case may be, or

(iii) the period during which the qualified investment entity was in existence.

(5) Treatment of certain wash sale transactions.—

(i) Election by Foreign Corporation to Be Treated as Domestic Corporation.—

(1) In general.— If—

(A) a foreign corporation holds a United States real property interest, and

(B) under any treaty obligation of the United States the foreign corporation is entitled to nondiscriminatory treatment with respect to that interest,

then such foreign corporation may make an election to be treated as a domestic corporation for purposes of this interest, after June 18, 1980, which would be taken into account under subsection (a) shall be taxable notwithstanding any provision to the contrary in a treaty to which the United States is a party, and

(B) subject to such other conditions as the Secretary may prescribe by regulations with respect to the corporation or its shareholders.

In the case of a class of interest (other than an interest solely as a creditor) which is regularly traded on an established securities market, the consent described in subparagraph (A) need only be made by any person if such person held more than 5 percent of such class of interest at some time during the shorter of the periods described in subsection (c)(1)(A)(ii). The constructive ownership rules of subsection (c)(6)(C) shall apply in determining whether a person held more than 5 percent of a class of interest.

(4) Exclusive method of claiming nondiscrimination.— The election provided by paragraph (1) shall be the exclusive remedy for any person claiming discriminatory treatment with respect to this section, section 1445, and section 6039C.

(j) Certain Contributions to Capital.— Except to the extent otherwise provided in regulations, gain shall be recognized by a nonresident alien individual or foreign corporation on the transfer of a United States real property interest to a foreign corporation if the transfer is made as paid in surplus or as a contribution to capital, in the amount of the excess of—

(1) the fair market value of such property transferred, over

(2) the sum of—

(A) the adjusted basis of such property in the hands of the transferor, plus

(B) the amount of gain, if any, recognized to the transferor under any other provision at the time of the transfer.

Section 898.
Taxable Year of Certain Foreign Corporations

(a) General Rule.— For purposes of this section, section 1445, and section 6039C.

(b) Specified foreign corporation.— For purposes of this section—

(1) In general.— The term “specified foreign corporation” means any foreign corporation—

(A) which is treated as a controlled foreign corporation for any purpose under subpart F of part III of this subchapter, and

IRC § 898(b)
(B) with respect to which the ownership requirements of paragraph (2) are met.

(2) Ownership requirements.—

(A) In general.— The ownership requirements of this paragraph are met with respect to any foreign corporation if a United States shareholder owns, on each testing day, more than 50 percent of—

(i) the total voting power of all classes of stock of such corporation entitled to vote, or

(ii) the total value of all classes of stock of such corporation.

(B) Ownership.— For purposes of subparagraph (A), the rules of subsections (a) and (b) of section 958 shall apply in determining ownership.

(3) United States shareholder.— The term “United States shareholder” has the meaning given to such term by section 951(b), except that, in the case of a foreign corporation having related person insurance income (as defined in section 953(c)(2)), the Secretary may treat any person as a United States shareholder for purposes of this section if such person is treated as a United States shareholder under section 953(c)(1).

(c) Determination of required year.—

(1) In general.— The required year is—

(A) the majority U.S. shareholder year, or

(B) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations.

(2) 1-month deferral allowed.— A specified foreign corporation may elect, in lieu of the taxable year under paragraph (1)(A), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.

(3) Majority U.S. shareholder year.—

(A) In general.— For purposes of this subsection, the term “majority U.S. shareholder year” means the taxable year (if any) which, on each testing day, constituted the taxable year of—

(i) each United States shareholder described in subsection (b)(2)(A), and

(ii) each United States shareholder not described in clause (i) whose stock was treated as owned under subsection (b)(2)(B) by any shareholder described in such clause.

(B) Testing day.— The testing days shall be—

(i) the first day of the corporation’s taxable year (determined without regard to this section), or

(ii) the days during such representative period as the Secretary may prescribe.

(a) Allowance of Credit.— If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b).

(b) Amount Allowed.— Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) Citizens and domestic corporations.— In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) Resident of the United States or Puerto Rico.— In the case of a resident of the United States and in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) Alien resident of the United States or Puerto Rico.— In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country; and

(4) Nonresident alien individuals and foreign corporations.— In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and

(5) Partnerships and estates.— In the case of any person described in paragraph (1), (2), (3), or (4), who is a member of a partnership or a beneficiary of an estate or trust, the amount of his proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid
or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be. Under rules or regulations prescribed by the Secretary, in the case of any foreign trust of which the settlor or another person would be treated as owner of any portion of the trust under subpart E but for section 672(f), the term “taxes imposed on the trust” includes the allocable amount of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the settlor or such other person in respect of trust income.

(c) Similar Credit Required for Certain Alien Residents.—Whenever the President finds that—

(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b)(3),

(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

(3) it is in the public interest to allow the credit under subsection (b)(3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country, the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b)(3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit.

(d) Treatment of Dividends from a DISC or Former DISC.—For purposes of this subpart, dividends from a DISC or former DISC (as defined in section 992(a)) shall be treated as dividends from a foreign corporation to the extent such dividends are treated under part I as income from sources without the United States.

(e) Foreign Taxes on Mineral Income.—

(1) Reduction in amount allowed.—Notwithstanding subsection (b), the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or possession of the United States with respect to foreign mineral income from sources within such country or possession which would (but for this paragraph) be allowed under such subsection shall be reduced by the amount (if any) by which—

(A) the amount of such taxes (or, if smaller, the amount of the tax which would be computed under this chapter with respect to such income determined without the deduction allowed under section 613), exceeds

(B) the amount of the tax computed under this chapter with respect to such income.

(2) Foreign mineral income defined.—For purposes of paragraph (1), the term “foreign mineral income” means income derived from the extraction of minerals from mines, wells, or other natural deposits, the processing of such minerals into their primary products, and the transportation, distribution, or sale of such minerals or primary products. Such term includes, but is not limited to—

(A) dividends received from a foreign corporation in respect of which taxes are deemed paid by the taxpayer under section 902, to the extent such dividends are attributable to foreign mineral income, and

(B) that portion of the taxpayer’s distributive share of the income of partnerships attributable to foreign mineral income.

(f) Certain Payments for Oil or Gas Not Considered as Taxes.—Notwithstanding subsection (b) and sections 902 and 960, the amount of any income, or profits, and excess profits taxes paid or accrued during the taxable year to any foreign country in connection with the purchase and sale of oil or gas extracted in such country is not to be considered as tax for purposes of section 275(a) and this section if—

(1) the taxpayer has no economic interest in the oil or gas to which section 611(a) applies, and

(2) either such purchase or sale is at a price which differs from the fair market value for such oil or gas at the time of such purchase or sale.

(g) Certain Taxes Paid With Respect to Distributions from Possessions Corporations.—

(1) In general.—For purposes of this chapter, any tax of a foreign country or possession of the United States which is paid or accrued with respect to any distribution from a corporation—

(A) to the extent that such distribution is attributable to periods during which such corporation is a possessions corporation, and

(B) (i) if a dividends received deduction is allowable with respect to such distribution under part VIII of subchapter B, or

(ii) to the extent that such distribution is received in connection with a liquidation or other transaction with respect to which gain or loss is not recognized,
shall not be treated as income, war profits, or excess profits
taxes paid or accrued to a foreign country or possession of the
United States, and no deduction shall be allowed under this
title with respect to any amount so paid or accrued.

(2) Possessions corporation.—For purposes of
paragraph (1), a corporation shall be treated as a possessions
corporation for any period during which an election under
section 936 applied to such corporation, during which section
931 (as in effect on the day before the date of the enactment
of the Tax Reform Act of 1976) applied to such corporation,
or during which section 957(c) (as in effect on the day before
the date of the enactment of the Tax Reform Act of 1986)
applied to such corporation.

(h) Taxes paid with respect to foreign trade income.—
[Repealed. Pub. L. 110-172, Sec. 11(g)(9), Dec. 29, 2007, 121
Stat. 2490.]

(i) Taxes Used to Provide Subsidies.—Any income, war
profits, or excess profits tax shall not be treated as a tax for
purposes of this title to the extent—

(1) the amount of such tax is used (directly or indirectly)
by the country imposing such tax to provide a subsidy by any
means to the taxpayer, a related person (within the meaning
of section 482), or any party to the transaction or to a related
transaction, and

(2) such subsidy is determined (directly or indirectly) by
reference to the amount of such tax, or the base used to com-
pute the amount of such tax.

(j) Denial of Foreign Tax Credit, Etc., With Respect to
Certain Foreign Countries.—

(1) In general.—Notwithstanding any other provision of
this part—

(A) no credit shall be allowed under subsection (a) for
any income, war profits, or excess profits taxes paid or
accrued (or deemed paid under section 902 or 960) to any
country if such taxes are with respect to income attributable to a period during which this subsection applies to such country, and

(B) subsections (a), (b), and (c) of section 904 and
sections 902 and 960 shall be applied separately with
respect to income attributable to such a period from
sources within such country.

(2) Countries to which subsection applies.—

(A) In general.—This subsection shall apply to any
foreign country—

(i) the government of which the United States does
not recognize, unless such government is otherwise
eligible to purchase defense articles or services under
the Arms Export Control Act,

(ii) with respect to which the United States has
severed diplomatic relations,

(iii) with respect to which the United States has not
severed diplomatic relations but does not conduct such
relations, or

(iv) which the Secretary of State has, pursuant to
section 6(j) of the Export Administration Act of 1979, as
amended, designated as a foreign country which repeat-
edly provides support for acts of international terrorisms [sic].

(B) Period for which subsection applies.—This
subsection shall apply to any foreign country described in
subparagraph (A) during the period—

(i) beginning on the later of—

(I) January 1, 1987, or

(II) 6 months after such country becomes a coun-
try described in subparagraph (A), and

(ii) ending on the date the Secretary of State certifies
to the Secretary of the Treasury that such country is no
longer described in subparagraph (A).

(C) Special rule for South Africa.—

(i) In general.—In addition to any period during
which this subsection would otherwise apply to South
Africa, this subsection shall apply to South Africa during
the period—

(I) beginning on January 1, 1988, and

(II) ending on the date the Secretary of State
certifies to the Secretary of the Treasury that South
Africa meets the requirements of section 311(a) of
the Comprehensive Anti-Apartheid Act of 1986 (as in
effect on the date of the enactment of this subpara-
graph).

(ii) South Africa defined.—For purposes of clause
(i), the term “South Africa” has the meaning given to
such term by paragraph (6) of section 3 of the Compre-
hensive Anti-Apartheid Act of 1986 (as so in effect).

(3) Taxes allowed as a deduction, etc.—Sections 275
and 78 shall not apply to any tax which is not allowable as a
credit under subsection (a) by reason of this subsection.

(4) Regulations.—The Secretary shall prescribe such
regulations as may be necessary or appropriate to carry out
the purposes of this subsection, including regulations which
treat income paid through 1 or more entities as derived from
a foreign country to which this subsection applies if such
income was, without regard to such entities, derived from
such country.
(k) Minimum holding period for certain taxes on dividends.–

(1) Withholding Taxes.–

(A) In general.– In no event shall a credit be allowed under subsection (a) for any withholding tax on a dividend with respect to stock in a corporation if—

(i) such stock is held by the recipient of the dividend for 15 days or less during the 31-day period beginning on the date which is 15 days before the date on which such share becomes ex-dividend with respect to such dividend, or

(ii) to the extent that the recipient of the dividend is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(B) Withholding tax.– For purposes of this paragraph, the term “withholding tax” includes any tax determined on a gross basis; but does not include any tax which is in the nature of a prepayment of a tax imposed on a net basis.

(2) Deemed Paid Taxes.– In the case of income, war profits, or excess profits taxes deemed paid under section 853, 902, or 960 through a chain of ownership of stock in 1 or more corporations, no credit shall be allowed under subsection (a) for such taxes if—

(A) any stock of any corporation in such chain (the ownership of which is required to obtain credit under subsection (a) for such taxes) is held for less than the period described in paragraph (1)(A)(i), or

(B) the corporation holding the stock is under an obligation referred to in paragraph (1)(A)(ii).

(3) 45-day rule in the case of certain preference dividends.– In the case of stock having preference in dividends and dividends with respect to stock which are attributable to a period or periods aggregating in excess of 366 days, paragraph (1)(A)(i) shall be applied—

(A) by substituting “45 days” for “15 days” each place it appears, and

(B) by substituting “91-day period” for “31-day period”.

(4) Exception for Certain Taxes Paid by Securities Dealers.–

(A) In general.– Paragraphs (1) and (2) shall not apply to any qualified tax with respect to any security held in the active conduct in a foreign country of a business as a securities dealer of any person—

(i) who is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934,

(ii) who is registered as a Government securities broker or dealer under section 15C(a) of such Act, or

(iii) who is licensed or authorized in such foreign country to conduct securities activities in such country and is subject to bona fide regulation by a securities regulating authority of such country.

(B) Qualified tax.– For purposes of subparagraph (A), the term “qualified tax” means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

(i) the dividend to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

(C) Regulations.– The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

(5) Certain rules to apply.– For purposes of this subsection, the rules of paragraphs (3) and (4) of section 246(c) shall apply.

(6) Treatment of bona fide sales.– If a person’s holding period is reduced by reason of the application of the rules of section 246(c)(4) to any contract for the bona fide sale of stock, the determination of whether such person’s holding period meets the requirements of paragraph (2) with respect to taxes deemed paid under section 902 or 960 shall be made as of the date such contract is entered into.

(7) Taxes allowed as deduction, etc.– Sections 275 and 78 shall not apply to any tax which is not allowable as a credit under subsection (a) by reason of this subsection.

(l) Minimum holding period for withholding taxes on gain and income other than dividends etc.–(1) In general.– In no event shall a credit be allowed under subsection (a) for any withholding tax (as defined in subsection (k)) on any item of income or gain with respect to any property if—

(A) such property is held by the recipient of the item for 15 days or less during the 31-day period beginning on the date which is 15 days before the date on which the right to receive payment of such item arises, or

(B) to the extent that the recipient of the item is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(2) Exception for taxes paid by dealers.–

(A) In general.– Paragraph (1) shall not apply to any qualified tax with respect to any property held in the active
conduct in a foreign country of a business as a dealer in such property.

(B) Qualified tax.—For purposes of subparagraph (A), the term “qualified tax” means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

(i) the item to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

(C) Dealer.—For purposes of subparagraph (A), the term “dealer” means—

(i) with respect to a security, any person to whom paragraphs (1) and (2) of subsection (k) would not apply by reason of paragraph (4) thereof, and

(ii) with respect to any other property, any person with respect to whom such property is described in section 1221(a)(1).

(D) Regulations.—The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

(3) Exceptions.—The Secretary may by regulation provide that paragraph (1) shall not apply to property where the Secretary determines that the application of paragraph (1) to such property is not necessary to carry out the purposes of this subsection.

(4) Certain rules to apply.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (k) shall apply for purposes of this subsection.

(5) Determination of holding period.—Holding periods shall be determined for purposes of this subsection without regard to section 1235 or any similar rule.

(m) Cross Reference.—

(1) For deductions of income, war profits, and excess profits taxes paid to a foreign country or a possession of the United States, see sections 164 and 275.

(2) For right of each partner to make election under this section, see section 703(b).

(3) For right of estate or trust to the credit for taxes imposed by foreign countries and possessions of the United States under this section, see section 642(a).

(4) For reduction of credit for failure of a United States person to furnish certain information with respect to a foreign corporation controlled by him, see section 6038.

Section 902.
Deemed Paid Credit Where Domestic Corporation Owns 10 Percent or More of Voting Stock of Foreign Corporation

(a) Taxes paid by foreign corporation treated as paid by domestic corporation.—For purposes of this subpart, a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of such foreign corporation’s post-1986 foreign income taxes as—

(1) the amount of such dividends (determined without regard to section 78), bears to

(2) such foreign corporation’s post-1986 undistributed earnings.

(b) Deemed Taxes Increased in Case of Certain Lower Tier Corporations.—

(1) In general.—If—

(A) any foreign corporation is a member of a qualified group, and

(B) such foreign corporation owns 10 percent or more of the voting stock of another member of such group from which it receives dividends in any taxable year, such foreign corporation shall be deemed to have paid the same proportion of such other member’s post-1986 foreign income taxes as would be determined under subsection (a) if such foreign corporation were a domestic corporation.

(2) Qualified group.—For purposes of paragraph (1), the term “qualified group” means—

(A) the foreign corporation described in subsection (a), and

(B) any other foreign corporation if—

(i) the domestic corporation owns at least 5 percent of the voting stock of such other foreign corporation indirectly through a chain of foreign corporations connected through stock ownership of at least 10 percent of their voting stock,

(ii) the foreign corporation described in subsection (a) is the first tier corporation in such chain, and

(iii) such other corporation is not below the sixth tier in such chain.

The term “qualified group” shall not include any foreign corporation below the third tier in the chain referred to in clause (i) unless such foreign corporation is a controlled foreign corporation (as defined in section 957) and the domestic corporation is a United States shareholder (as defined in section 951(b)) in such foreign corporation. Paragraph (1)
shall apply to those taxes paid by a member of the qualified group below the third tier only with respect to periods during which it was a controlled foreign corporation.

(c) Definitions and Special Rules.—For purposes of this section—

(1) Post-1986 undistributed earnings.—The term "post-1986 undistributed earnings" means the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986) accumulated in taxable years beginning after December 31, 1986—

(A) as of the close of the taxable year of the foreign corporation in which the dividend is distributed, and

(B) without diminution by reason of dividends distributed during such taxable year.

(2) Post-1986 foreign income taxes.—The term "post-1986 foreign income taxes" means the sum of—

(A) the foreign income taxes with respect to the taxable year of the foreign corporation in which the dividend is distributed, and

(B) the foreign income taxes with respect to prior taxable years beginning after December 31, 1986, to the extent such foreign taxes were not attributable to dividends distributed by the foreign corporation in prior taxable years.

(3) Special rule where foreign corporation first qualifies after December 31, 1986.—

(A) In general.—If the 1st day on which the requirements of subparagraph (B) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 foreign income taxes of such foreign corporation shall be determined by taking into account only periods beginning on and after the 1st day of the 1st taxable year in which such requirements are met.

(B) Requirements.—The requirements of this subparagraph are met with respect to any foreign corporation if—

(i) 10 percent or more of the voting stock of such foreign corporation is owned by a domestic corporation, or

(ii) the requirements of subsection (b)(2) are met with respect to such foreign corporation.

(4) Foreign income taxes.—

(A) In general.—The term "foreign income taxes" means any income, war profits, or excess profits taxes paid by the foreign corporation to any foreign country or possession of the United States.

(B) Treatment of deemed taxes.—Except for purposes of determining the amount of the post-1986 foreign income taxes of a sixth tier foreign corporation referred to in subsection (b)(2), the term "foreign income taxes" includes any such taxes deemed to be paid by the foreign corporation under this section.

(5) Accounting periods.—In the case of a foreign corporation the income, war profits, and excess profits taxes of which are determined on the basis of an accounting period of less than 1 year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(6) Treatment of distributions from earnings before 1987.—

(A) In general.—In the case of any dividend paid by a foreign corporation out of accumulated profits (as defined in this section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) for taxable years beginning before the 1st taxable year taken into account in determining the post-1986 undistributed earnings of such corporation—

(i) this section (as amended by the Tax Reform Act of 1986) shall not apply, but

(ii) this section (as in effect on the day before the date of the enactment of such Act) shall apply.

(B) Dividends paid first out of post-1986 earnings.—Any dividend in a taxable year beginning after December 31, 1986, shall be treated as made out of post-1986 undistributed earnings to the extent thereof.

(7) Constructive ownership through partnerships.—Stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by its partners. Stock considered to be owned by a person by reason of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person. The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including rules to account for special partnership allocations of dividends, credits, and other incidents of ownership of stock in determining proportionate ownership.

(8) Regulations.—The Secretary shall provide such regulations as may be necessary or appropriate to carry out the provisions of this section and section 960, including provisions which provide for the separate application of this section and section 960 to reflect the separate application of section 904 to separate types of income and loss.

(d) Cross References.—

(1) For inclusion in gross income of an amount equal to taxes deemed paid under subsection (a), see section 78.

(2) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States
shareholder with respect to a controlled foreign corporation, see section 960.

(3) For reduction of credit with respect to dividends paid out of post-1986 undistributed earnings for years for which certain information is not furnished, see section 6038.

Section 903.
Credit for Taxes in Lieu of Income, Etc., Taxes

For purposes of this part and of sections 164(a) and 275(a), the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

Section 904.
Limitation on Credit

(a) Limitation.—The total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer’s taxable income from sources without the United States (but not in excess of the taxpayer’s entire taxable income) bears to his entire taxable income for the same taxable year.

(b) Taxable income for purpose of computing limitation.—

(1) Personal exemptions.—For purposes of subsection (a), the taxable income in the case of an individual, estate, or trust shall be computed without any deduction for personal exemptions under section 151 or 642(b).

(2) Capital gains.—For purposes of this section—

(A) In general.—Taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income.

(B) Special rules where capital gain rate differential.—In the case of any taxable year for which there is a capital gain rate differential—

(i) in lieu of applying subparagraph (A), the taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only in an amount equal to foreign source capital gain net income reduced by the rate differential portion of foreign source net capital gain,

(ii) the entire taxable income shall include gain from the sale or exchange of capital assets only in an amount equal to capital gain net income reduced by the rate differential portion of net capital gain, and

(iii) for purposes of determining taxable income from sources outside the United States, any net capital loss (and any amount which is a short-term capital loss under section 1212(a)) from sources outside the United States to the extent taken into account in determining capital gain net income for the taxable year shall be reduced by an amount equal to the rate differential portion of the excess of net capital gain from sources within the United States over net capital gain.

(C) Coordination with capital gains rates.—The Secretary may by regulations modify the application of this paragraph and paragraph (3) to the extent necessary to properly reflect any capital gain rate differential under section 1(h) or 1201(a) and the computation of net capital gain.

(3) Definitions.—For purposes of this subsection—

(A) Foreign source capital gain net income.—The term “foreign source capital gain net income” means the lesser of—

(i) capital gain net income from sources without the United States, or

(ii) capital gain net income.

(B) Foreign source net capital gain.—The term “foreign source net capital gain” means the lesser of—

(i) net capital gain from sources without the United States, or

(ii) net capital gain.

(C) Section 1231 gains.—The term “gain from the sale or exchange of capital assets” includes any gain so treated under section 1231.

(D) Capital gain rate differential.—There is a capital gain rate differential for any taxable year if—

(i) in the case of a taxpayer other than a corporation, subsection (h) of section 1 applies to such taxable year, or

(ii) in the case of a corporation, any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever applies) exceeds the alternative rate of tax under section 1201(a) (determined without regard to the last sentence of section 11(b)(1)).

(E) Rate differential portion.—

(i) In general.—The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as—

(I) the excess of the highest applicable tax rate over the alternative tax rate, bears to

(II) the highest applicable tax rate.
(ii) **Highest applicable tax rate.**— For purposes of clause (i), the term “highest applicable tax rate” means—

(I) in the case of a taxpayer other than a corporation, the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies), or

(II) in the case of a corporation, the highest rate of tax specified in section 11(b).

(iii) **Alternative tax rate.**— For purposes of clause (i), the term “alternative tax rate” means—

(I) in the case of a taxpayer other than a corporation, the alternative rate of tax determined under section 1(h), or

(II) in the case of a corporation, the alternative rate of tax under section 1201(a).

(4) **Coordination with section 936.**— For purposes of subsection (a), in the case of a corporation, the taxable income shall not include any portion thereof taken into account for purposes of the credit (if any) allowed by section 936 (without regard to subsections (a)(4) and (i) thereof).

(c) **Carryback and carryover of excess tax paid.**— Any amount by which all taxes paid or accrued to foreign countries or possessions of the United States for any taxable year for which the taxpayer chooses to have the benefits of this subpart exceed the limitation under subsection (a) shall be deemed taxes paid or accrued to foreign countries or possessions of the United States in the first preceding taxable year and in any of the first 10 succeeding taxable years, in that order and to the extent not deemed taxes paid or accrued in a prior taxable year, in the amount by which the limitation under subsection (a) for such preceding or succeeding taxable year exceeds the sum of the taxes paid or accrued to foreign countries or possessions of the United States for such preceding or succeeding taxable year and the amount of the taxes for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as a deduction and only if the taxpayer for such year chooses to have the benefits of this subpart to as to taxes paid or accrued for that year to foreign countries or possessions of the United States.

(d) **Separate application of section with respect to certain categories of income.**—

(1) **In general.**— The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to—

(A) passive category income, and

(B) general category income.

(2) **Definitions and special rules.**— For purposes of this subsection—

(A) **Categories.**—

(i) **Passive category income.**— The term “passive category income” means passive income and specified passive category income.

(ii) **General category income.**— The term “general category income” means income other than passive category income.

(B) **Passive income.**—

(i) **In general.**— Except as otherwise provided in this subparagraph, the term “passive income” means any income received or accrued by any person which is of a kind which would be foreign personal holding company income (as defined in section 954(c)).

(ii) **Certain amounts included.**— Except as provided in clause (iii), the term “passive income” includes, except as provided in subparagraph (E)(ii) or paragraph (3)(H), any amount includible in gross income under section 1293 (relating to certain passive foreign investment companies).

(iii) **Exceptions.**— The term “passive income” shall not include—

(I) any export financing interest, and

(II) any high-taxed income.

(iv) **Clarification of application of section 864(d)(6).**— In determining whether any income is of a kind which would be foreign personal holding company income, the rules of section 864(d)(6) shall apply only in the case of income of a controlled foreign corporation.

(v) **Specified passive category income.**— The term “specified passive category income” means—

(I) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States,

(II) taxable income attributable to foreign trade income (within the meaning of section 923(b)), and

(III) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)).
(C) Treatment of Financial Services Income and Companies.—

(i) In general.—Financial services income shall be treated as general category income in the case of—

(I) a member of a financial services group, and

(II) any other person if such person is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business.

(ii) Financial services group.—The term “financial services group” means any affiliated group (as defined in section 1504(a) without regard to paragraphs (2) and (3) of section 1504(b)) which is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. In determining whether such a group is so engaged, there shall be taken into account only the income of members of the group that are—

(I) United States corporations, or

(II) controlled foreign corporations in which such United States corporations own, directly or indirectly, at least 80 percent of the total voting power and value of the stock.

(iii) Pass-thru entities.—The Secretary shall by regulation specify for purposes of this subparagraph the treatment of financial services income received or accrued by partnerships and by other pass-thru entities which are not members of a financial services group.

(D) Financial services income.—

(i) In general.—Except as otherwise provided in this subparagraph, the term “financial services income” means any income which is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, and which is—

(I) described in clause (ii), or

(II) passive income (determined without regard to subparagraph (B)(iii)(II)).

(ii) General description of financial services income.—Income is described in this clause if such income is—

(I) derived in the active conduct of a banking, financing, or similar business,

(II) derived from the investment by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business, or

(III) of a kind which would be insurance income as defined in section 953(a) determined without regard to those provisions of paragraph (1)(A) of such section which limit insurance income to income from countries other than the country in which the corporation was created or organized.


(E) Noncontrolled section 902 corporation.—

(i) In general.—The term “noncontrolled section 902 corporation” means any foreign corporation with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraph (3) or (4), the requirements of section 902(b)). A controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation.

(ii) Treatment of inclusions under section 1293.—If any foreign corporation is a non-controlled section 902 corporation with respect to the taxpayer, any inclusion under section 1293 with respect to such corporation shall be treated as a dividend from such corporation.

(F) High-taxed income.—The term “high-taxed income” means any income which (but for this subparagraph) would be passive income if the sum of—

(I) the foreign income taxes paid or accrued by the taxpayer with respect to such income, and

(ii) the foreign income taxes deemed paid by the taxpayer with respect to such income under section 902 or 960,

exceeds the highest rate of tax specified in section 1 or 11 (whichever applies) multiplied by the amount of such income (determined with regard to section 78). For purposes of the preceding sentence, the term “foreign income taxes” means any income, war profits, or excess profits tax imposed by any foreign country or possession of the United States.

(G) Export financing interest.—For purposes of this paragraph, the term “export financing interest” means any interest derived from financing the sale (or other disposition) for use or consumption outside the United States of any property—

(I) which is manufactured, produced, grown, or extracted in the United States by the taxpayer or a related person, and

(ii) not more than 50 percent of the fair market value of which is attributable to products imported into the United States.

For purposes of clause (ii), the fair market value of any property imported into the United States shall be its appraised value, as determined by the Secretary under

IRC § 904(d)

(H) Treatment of Income Tax Base Differences.—

(i) In General.—In the case of taxable years beginning after December 31, 2006, tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles shall be treated as imposed on income described in paragraph (1)(B).

(ii) Special Rule for Years Before 2007.—

(I) In General.—In the case of taxes paid or accrued in taxable years beginning after December 31, 2004, and before January 1, 2007, a taxpayer may elect to treat tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles as tax imposed on income described in subparagraph (C) or (I) of paragraph (1).

(II) Election Irrevocable.—Any such election shall apply to the taxable year for which made and all subsequent taxable years described in subclause (I) unless revoked with the consent of the Secretary.

(I) Related Person.—For purposes of this paragraph, the term “related person” has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting “the person with respect to whom the determination is being made” for “controlled foreign corporation” each place it appears.

(J) Transitional Rule.—For purposes of paragraph (1)—

(i) Taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income which was described in subparagraph (A) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to income described in subparagraph (A) of paragraph (1) (as in effect after such date),

(ii) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income which was described in subparagraph (E) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to income described in subparagraph (I) of paragraph (1) (as in effect after such date) except that—

(I) such taxes shall be treated as paid or accrued with respect to shipping income to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income,

(II) in the case of a person described in subparagraph (C)(i), such taxes shall be treated as paid or accrued with respect to financial services income to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income, and

(III) such taxes shall be treated as paid or accrued with respect to high withholding tax interest to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income, and

(iii) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income described in any other subparagraph of paragraph (1) (as so in effect before such date) shall be treated as taxes paid or accrued with respect to income described in the corresponding subparagraph of paragraph (1) (as so in effect after such date).

(K) Transitional Rules for 2007 Changes.—For purposes of paragraph (1)—

(i) taxes carried from any taxable year beginning before January 1, 2007, to any taxable year beginning on or after such date, with respect to any item of income, shall be treated as described in the subparagraph of paragraph (1) in which such income would be described were such taxes paid or accrued in a taxable year beginning on or after such date, and

(ii) the Secretary may by regulations provide for the allocation of any carryback of taxes with respect to income from a taxable year beginning on or after January 1, 2007, to a taxable year beginning before such date for purposes of allocating such income among the separate categories in effect for the taxable year to which carried.

(3) Look-Through in Case of Controlled Foreign Corporations.—

(A) In General.—Except as otherwise provided in this paragraph, dividends, interest, rent, and royalties received or accrued by the taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall not be treated as passive category income.

(B) Subpart F Inclusions.—Any amount included in gross income under section 951(a)(1)(A) shall be treated as passive category income to the extent the amount so included is attributable to passive category income.

(C) Interest, Rents, and Royalties.—Any interest, rent, or royalty which is received or accrued from a controlled foreign corporation in which the taxpayer is a
United States shareholder shall be treated as passive category income to the extent it is properly allocable (under regulations prescribed by the Secretary) to passive category income of the controlled foreign corporation.

(D) Dividends.— Any dividend paid out of the earnings and profits of any controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as passive category income in proportion to the ratio of—

(i) the portion of the earnings and profits attributable to passive category income, to

(ii) the total amount of earnings and profits.

(E) Look-thru applies only where subpart F applies.— If a controlled foreign corporation meets the requirements of section 954(b)(3)(A) (relating to de minimis rule) for any taxable year, for purposes of this paragraph, none of its foreign base company income (as defined in section 954(a) without regard to section 954(b)(5)) and none of its gross insurance income (as defined in section 954(b)(3)(C)) for such taxable year shall be treated as passive category income, except that this sentence shall not apply to any income which (without regard to this sentence) would be treated as financial services income. Solely for purposes of applying subparagraph (D), passive income of a controlled foreign corporation shall not be treated as passive category income if the requirements of section 954(b)(4) are met with respect to such income.

(F) Coordination with high-taxed income provisions.—

(i) In determining whether any income of a controlled foreign corporation is passive category income, subclause (II) of paragraph (2)(B)(iii) shall not apply.

(ii) Any income of the taxpayer which is treated as passive category income under this paragraph shall be so treated notwithstanding any provision of paragraph (2); except that the determination of whether any amount is high-taxed income shall be made after the application of this paragraph.

(G) Dividend.— For purposes of this paragraph, the term “dividend” includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

(H) Look-thru applies to passive foreign investment company inclusion.— If—

(i) a passive foreign investment company is a controlled foreign corporation, and

(ii) the taxpayer is a United States shareholder in such controlled foreign corporation, any amount included in gross income under section 1293 shall be treated as income in a separate category to the extent such amount is attributable to income in such category.

(4) Look-thru applies to dividends from noncontrolled section 902 corporations.—

(A) In general.— For purposes of this subsection, any dividend from a noncontrolled section 902 corporation with respect to the taxpayer shall be treated as income described in a subparagraph of paragraph (1) in proportion to the ratio of—

(i) the portion of earnings and profits attributable to income described in such subparagraph, to

(ii) the total amount of earnings and profits.

(B) Earnings and profits of controlled foreign corporations.— In the case of any distribution from a controlled foreign corporation to a United States shareholder, rules similar to the rules of subparagraph (A) shall apply in determining the extent to which earnings and profits of the controlled foreign corporation which are attributable to dividends received from a noncontrolled section 902 corporation may be treated as income in a separate category.

(C) Special rules.— For purposes of this paragraph—

(i) Earnings and profits.—

(I) In general.— The rules of section 316 shall apply.

(II) Regulations.— The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer’s acquisition of the stock to which the distributions relate.

(ii) Inadequate substantiation.— If the Secretary determines that the proper subparagraph of paragraph (1) in which a dividend is described has not been substantiated, such dividend shall be treated as income described in paragraph (1)(A).

(iii) Coordination with high-taxed income provisions.— Rules similar to the rules of paragraph (3)(F) shall apply for purposes of this paragraph.

(iv) Look-thru with respect to carryover of credit.— Rules similar to subparagraph (A) also shall apply to any carryforward under subsection (c) from a taxable year beginning before January 1, 2003, of tax allocable to a dividend from a noncontrolled section 902 corporation with respect to the taxpayer. The Secretary may by regulations provide for the allocation of any carryback of tax allocable to a dividend from a noncontrolled section 902 corporation from a taxable year beginning on or after January 1, 2003, to a taxable year
beginning before such date for purposes of allocating such dividend among the separate categories in effect for the taxable year to which carried.

(5) Controlled foreign corporation; United States shareholder.— For purposes of this subsection—

(A) Controlled foreign corporation.— The term “controlled foreign corporation” has the meaning given such term by section 957 (taking into account section 953(c)).

(B) United States shareholder.— The term “United States shareholder” has the meaning given such term by section 951(b) (taking into account section 953(c)).

(6) Regulations.— The Secretary shall prescribe such regulations as may be necessary or appropriate for the purposes of this subsection, including regulations—

(A) for the application of paragraph (3) and subsection (f)(5) in the case of income paid (or loans made) through 1 or more entities or between 2 or more chains of entities,

(B) preventing the manipulation of the character of income the effect of which is to avoid the purposes of this subsection, and

(C) providing that rules similar to the rules of paragraph (3)(C) shall apply to interest, rents, and royalties received or accrued from entities which would be controlled foreign corporations if they were foreign corporations.

(e) [Repealed—1990 Rev. Recon. Act, sec. 11801(a)(31)]

(f) Recapture of overall foreign loss.—

(1) General rule.— For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall foreign loss for any taxable year, that portion of the taxpayer’s taxable income from sources without the United States for each succeeding taxable year which is equal to the lesser of—

(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

(B) 50 percent (or such larger percent as the taxpayer may choose) of the taxpayer’s taxable income from sources without the United States for such succeeding taxable year, shall be treated as income from sources within the United States (and not as income from sources without the United States).

(2) Overall foreign loss defined.— For purposes of this subsection, the term “overall foreign loss” means the amount by which the gross income for the taxable year from sources without the United States (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) for such year is exceeded by the sum of the deductions properly apportioned or allocated thereto, except that there shall not be taken into account—

(A) any net operating loss deduction allowable for such year under section 172(a), and

(B) any—

(i) foreign expropriation loss for such year, as defined in section 172(h) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), or

(ii) loss for such year which arises from fire, storm, shipwreck, or other casualty, or from theft,

to the extent such loss is not compensated for by insurance or otherwise.

(3) Dispositions.—

(A) In general.— For purposes of this chapter, if property which has been used predominantly without the United States in a trade or business is disposed of during any taxable year—

(i) the taxpayer, notwithstanding any other provision of this chapter (other than paragraph (1)), shall be deemed to have received and recognized taxable income from sources without the United States in the taxable year of the disposition, by reason of such disposition, in an amount equal to the lesser of the excess of the fair market value of such property over the taxpayer’s adjusted basis in such property or the remaining amount of the overall foreign losses which were not used under paragraph (1) for such taxable year or any prior taxable year, and

(ii) paragraph (1) shall be applied with respect to such income by substituting “100 percent” for “50 percent”.

In determining for purposes of this subparagraph whether the predominant use of any property has been without the United States, there shall be taken into account use during the 3-year period ending on the date of the disposition (or, if shorter, the period during which the property has been used in the trade or business).

(B) Disposition defined and special rules.—

(i) For purposes of this subsection, the term “disposition” includes a sale, exchange, distribution, or gift of property whether or not gain or loss is recognized on the transfer.

(ii) Any taxable income recognized solely by reason of subparagraph (A) shall have the same characterization it would have had if the taxpayer had sold or exchanged the property.

(iii) The Secretary shall prescribe such regulations as he may deem necessary to provide for adjustments to
the basis of property to reflect taxable income recognized solely by reason of subparagraph (A).

(C) Exceptions.—Notwithstanding subparagraph (B), the term “disposition” does not include—

(i) a disposition of property which is not a material factor in the realization of income by the taxpayer, or

(ii) a disposition of property to a domestic corporation in a distribution or transfer described in section 381(a).

(D) Application to certain dispositions of stock in controlled foreign corporation.—

(i) In general.—This paragraph shall apply to an applicable disposition in the same manner as if it were a disposition of property described in subparagraph (A), except that the exception contained in subparagraph (C)(i) shall not apply.

(ii) Applicable disposition.—For purposes of clause (i), the term “applicable disposition” means any disposition of any share of stock in a controlled foreign corporation in a transaction or series of transactions if, immediately before such transaction or series of transactions, the taxpayer owned more than 50 percent (by vote or value) of the stock of the controlled foreign corporation. Such term shall not include a disposition described in clause (iii) or (iv), except that clause (i) shall apply to any gain recognized on any such disposition.

(iii) Exception for certain exchanges where ownership percentage retained.—A disposition shall not be treated as an applicable disposition under clause (ii) if it is part of a transaction or series of transactions—

(I) to which section 351 or 721 applies, or under which the transferor receives stock in a foreign corporation in exchange for the stock in the controlled foreign corporation and the stock received is exchanged basis property (as defined in section 7701(a)(44)), and

(II) immediately after which, the transferor owns (by vote or value) at least the same percentage of stock in the controlled foreign corporation (or, if the controlled foreign corporation is not in existence after such transaction or series of transactions, in another foreign corporation stock in which was received by the transferor in exchange for stock in the controlled foreign corporation) as the percentage of stock in the controlled foreign corporation which the taxpayer owned immediately before such transaction or series of transactions.

(iv) Exception for certain asset acquisitions.—A disposition shall not be treated as an applicable disposition under clause (ii) if it is part of a transaction or series of transactions in which the taxpayer (or any member of a controlled group of corporations filing a consolidated return under section 1501 which includes the taxpayer) acquires the assets of a controlled foreign corporation in exchange for the shares of the controlled foreign corporation in a liquidation described in section 332 or a reorganization described in section 368(a)(1).

(v) Controlled foreign corporation.—For purposes of this subparagraph, the term “controlled foreign corporation” has the meaning given such term by section 957.

(vi) Stock ownership.—For purposes of this subparagraph, ownership of stock shall be determined under the rules of subsections (a) and (b) of section 958.

(4) Accumulation distributions of foreign trust.—For purposes of this chapter, in the case of amounts of income from sources without the United States which are treated under section 666 (without regard to subsections (b) and (c) thereof if the taxpayer chose to take a deduction with respect to the amounts described in such subsections under section 667(d)(1)(B)) as having been distributed by a foreign trust in a preceding taxable year, that portion of such amounts equal to the amount of any overall foreign loss sustained by the beneficiary in a year prior to the taxable year of the beneficiary in which such distribution is received from the trust shall be treated as income from sources within the United States (and not income from sources without the United States) to the extent that such loss was not used under this subsection in prior taxable years, or in the current taxable year, against other income of the beneficiary.

(5) Treatment of separate limitation losses.—

(A) In general.—The amount of the separate limitation losses for any taxable year shall reduce income from sources within the United States for such taxable year only to the extent the aggregate amount of such losses exceeds the aggregate amount of the separate limitation incomes for such taxable year.

(B) Allocation of losses.—The separate limitation losses for any taxable year (to the extent such losses do not exceed the separate limitation incomes for such year) shall be allocated among (and operate to reduce) such incomes on a proportionate basis.

(C) Recharacterization of subsequent income.—If—

(I) a separate limitation loss from any income category (hereinafter in this subparagraph referred to as “the loss category”) was allocated to income from any other category under subparagraph (B), and
(ii) the loss category has income for a subsequent taxable year,
such income (to the extent it does not exceed the aggregate separate limitation losses from the loss category not previously recharacterized under this subparagraph) shall be recharacterized as income from such other category in proportion to the prior reductions under subparagraph (B) in such other category not previously taken into account under this subparagraph. Nothing in the preceding sentence shall be construed as recharacterizing any tax.

(D) Special rules for losses from sources in the United States.—Any loss from sources in the United States for any taxable year (to the extent such loss does not exceed the separate limitation incomes from such year) shall be allocated among (and operate to reduce) such incomes on a proportionate basis. This subparagraph shall be applied after subparagraph (B).

(E) Definitions.—For purposes of this paragraph—

(i) Income category.—The term “income category” means each separate category of income described in subsection (d)(1).

(ii) Separate limitation income.—The term “separate limitation income” means, with respect to any income category, the taxable income from sources outside the United States, separately computed for such category.

(iii) Separate limitation loss.—The term “separate limitation loss” means, with respect to any income category, the loss from such category determined under the principles of section 907(c)(4)(B).

(F) Dispositions.—If any separate limitation loss for any taxable year is allocated against any separate limitation income for such taxable year, except to the extent provided in regulations, rules similar to the rules of paragraph (3) shall apply to any disposition of property if gain from such disposition would be in the income category with respect to which there was such separate limitation loss.

(g) Recharacterization of Overall Domestic Loss.—

(1) General rule.—For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall domestic loss for any taxable year beginning after December 31, 2006, that portion of the taxpayer’s taxable income from sources within the United States for each succeeding taxable year which is equal to the lesser of—

(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

(B) 50 percent of the taxpayer’s taxable income from sources within the United States for such succeeding taxable year,

shall be treated as income from sources without the United States (and not as income from sources within the United States).

(2) Overall domestic loss defined.—For purposes of this subsection—

(A) In general.—The term “overall domestic loss” means any domestic loss to the extent such loss offsets taxable income from sources without the United States for the taxable year or for any preceding taxable year by reason of a carryback. For purposes of the preceding sentence, the term “domestic loss” means the amount by which the gross income for the taxable year from sources within the United States is exceeded by the sum of the deductions properly apportioned or allocated thereto (determined without regard to any carryback from a subsequent taxable year).

(B) Taxpayer must have elected foreign tax credit for year of loss.—The term “overall domestic loss” shall not include any loss for any taxable year unless the taxpayer chose the benefits of this subpart for such taxable year.

(3) Characterization of subsequent income.—

(A) In general.—Any income from sources within the United States that is treated as income from sources without the United States under paragraph (1) shall be allocated among and increase the income categories in proportion to the loss from sources within the United States previously allocated to those income categories.

(B) Income category.—For purposes of this paragraph, the term “income category” has the meaning given such term by subsection (f)(5)(E)(i).

(4) Coordination with subsection (f).—The Secretary shall prescribe such regulations as may be necessary to coordinate the provisions of this subsection with the provisions of subsection (f).

(h) Source rules in case of United States-owned foreign corporations.—

(1) In general.—The following amounts which are derived from a United States-owned foreign corporation and which would be treated as derived from sources outside the United States without regard to this subsection shall, for purposes of this section, be treated as derived from sources within the United States to the extent provided in this subsection:

(A) Any amount included in gross income under—

(i) section 951(a) (relating to amounts included in gross income of United States shareholders), or

(ii) section 1293 (relating to current taxation of income from qualified funds).

(B) Interest.

(C) Dividends.
(2) Subpart F and passive foreign investment company inclusions.—Any amount described in subparagraph (A) of paragraph (1) shall be treated as derived from sources within the United States to the extent such amount is attributable to income of the United States-owned foreign corporation from sources within the United States.

(3) Certain interest allocable to United States source income.—Any interest which—

(A) is paid or accrued by a United States-owned foreign corporation during any taxable year,

(B) is paid or accrued to a United States shareholder (as defined in section 951(b)) or a related person (within the meaning of section 267(b)) to such a shareholder, and

(C) is properly allocable (under regulations prescribed by the Secretary) to income of such foreign corporation for the taxable year from sources within the United States, shall be treated as derived from sources within the United States.

(4) Dividends.—

(A) In general.—The United States source ratio of any dividend paid or accrued by a United States-owned foreign corporation shall be treated as derived from sources within the United States.

(B) United States source ratio.—For purposes of subparagraph (A), the term “United States source ratio” means, with respect to any dividend paid or accrued for any taxable year, a fraction—

(i) the numerator of which is the portion of the earnings and profits for such taxable year from sources within the United States, and

(ii) the denominator of which is the total amount of earnings and profits for such taxable year.

(5) Exception where United States-owned foreign corporation has small amount of United States source income.—Paragraph (3) shall not apply to interest paid or accrued during any taxable year (and paragraph (4) shall not apply to any dividends paid out of the earnings and profits for such taxable year) if—

(A) the United States-owned foreign corporation has earnings and profits for such taxable year, and

(B) less than 10 percent of such earnings and profits is attributable to sources within the United States.

For purposes of the preceding sentence, earnings and profits shall be determined without any reduction for interest described in paragraph (3) (determined without regard to subparagraph (C) thereof).

(6) United States-owned foreign corporation.—For purposes of this subsection, the term “United States-owned foreign corporation” means any foreign corporation if 50 percent or more of—

(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(B) the total value of the stock of such corporation, is held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30)).

(7) Dividends.—For purposes of this subsection, the term “dividend” includes any gain treated as ordinary income under section 1246 or as a dividend under section 1248.

(8) Coordination with subsection (f).—This subsection shall be applied before subsection (f).

(9) Treatment of certain domestic corporations.—For purposes of this subsection—

(A) in the case of interest treated as not from sources within the United States under section 861(a)(1)(A), the corporation paying such interest shall be treated as a United States-owned foreign corporation, and

(B) in the case of any dividend treated as not from sources within the United States under section 861(a)(2)(A), the corporation paying such dividend shall be treated as a United States-owned foreign corporation.

(10) Coordination with treaties.—

(A) In general.—If—

(i) any amount derived from a United States-owned foreign corporation would be treated as derived from sources within the United States under this subsection by reason of an item of income of such United States-owned foreign corporation,

(ii) under a treaty obligation of the United States (applied without regard to this subsection and by treating any amount included in gross income under section 951(a)(1) as a dividend), such amount would be treated as arising from sources outside the United States, and

(iii) the taxpayer chooses the benefits of this paragraph,

this subsection shall not apply to such amount to the extent attributable to such item of income (but subsections (a), (b), and (c) of this section and sections 902, 907, and 961(a)(2)(A), the corporation paying such dividend shall be treated as a United States-owned foreign corporation, and

(B) Special rule.—Amounts included in gross income under section 951(a)(1) shall be treated as a dividend under subparagraph (A)(ii) only if dividends paid by each corporation (the stock in which is taken into account in determining whether the shareholder is a United States shareholder in the United States-owned foreign corporation), if paid to the United States shareholder, would be treated under a treaty obligation of the United States as
arising from sources outside the United States (applied without regard to this subsection).

(11) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate for purposes of this subsection, including—

(A) regulations for the application of this subsection in the case of interest or dividend payments through 1 or more entities, and

(B) regulations providing that this subsection shall apply to interest paid or accrued to any person (whether or not a United States shareholder).

(i) Coordination with nonrefundable personal credits.—In the case of an individual, for purposes of subsection (a), the tax against which the credit is taken is such tax reduced by the sum of the credits allowable under subpart A of part IV of subchapter A of this chapter (other than sections 23, 24, 25A(i), 25B, 30, 30B, and 30D). This subsection shall not apply to taxable years beginning during 2000, 2001, 2002, 2003, 2004, or 2005.

(j) Limitation on use of deconsolidation to avoid foreign tax credit limitations.—If 2 or more domestic corporations would be members of the same affiliated group if—

(1) section 1504(b) were applied without regard to the exceptions contained therein, and

(2) the constructive ownership rules of section 1563(e) applied for purposes of section 1504(a),

the Secretary may by regulations provide for resourcing the income of any of such corporations or for modifications to the consolidated return regulations to the extent that such resourcing or modifications are necessary to prevent the avoidance of the provisions of this subpart.

(k) Certain individuals exempt.—

(1) In general.—In the case of an individual to whom this subsection applies for any taxable year—

(A) the limitation of subsection (a) shall not apply,

(B) no taxes paid or accrued by the individual during such taxable year may be deemed paid or accrued under subsection (c) in any other taxable year, and

(C) no taxes paid or accrued by the individual during any other taxable year may be deemed paid or accrued under subsection (c) in such taxable year.

(2) Individuals to whom subsection applies.—This subsection shall apply to an individual for any taxable year if—

(A) the entire amount of such individual’s gross income for the taxable year from sources without the United States consists of qualified passive income,

(B) the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year does not exceed $300 ($600 in the case of a joint return), and

(C) such individual elects to have this subsection apply for the taxable year.

(3) Definitions.—For purposes of this subsection—

(A) Qualified passive income.—The term “qualified passive income” means any item of gross income if—

(i) such item of income is passive income (as defined in subsection (d)(2)(B) without regard to clause (iii) thereof), and

(ii) such item of income is shown on a payee statement furnished to the individual.

(B) Creditable foreign taxes.—The term “creditable foreign taxes” means any taxes for which a credit is allowable under section 901; except that such term shall not include any tax unless such tax is shown on a payee statement furnished to such individual.

(C) Payee statement.—The term “payee statement” has the meaning given to such term by section 6724(d)(2).

(D) Estates and trusts not eligible.—This subsection shall not apply to any estate or trust.

(l) Cross references.—

(1) For increase of limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(b).

(2) For modification of limitation under subsection (a) for purposes of determining the amount of credit which can be taken against the alternative minimum tax, see section 59(a).

Section 905. Applicable Rules

(a) Year in which credit taken.—The credits provided in this subpart may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c). If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken on the same basis.
and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(b) Proof of Credits.– The credits provided in this subpart shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary—

(1) the total amount of income derived from sources without the United States, determined as provided in part I,

(2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this subpart, such amount to be determined under regulations prescribed by the Secretary, and

(3) all other information necessary for the verification and computation of such credits.

(c) Adjustments to Accrued Taxes.–

(1) In general.– If—

(A) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer,

(B) accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate, or

(C) any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected. The Secretary may prescribe adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings under sections 902 and 960 in lieu of the redetermination under the preceding sentence.

(2) Special rule for taxes not paid within 2 years.–

(A) In general.– Except as provided in subparagraph (B), in making the redetermination under paragraph (1), no credit shall be allowed for accrued taxes not paid before the date referred to in subparagraph (B) of paragraph (1).

(B) Taxes subsequently paid.– Any such taxes if subsequently paid—

(i) shall be taken into account—

(1) in the case of taxes deemed paid under section 902 or section 960, for the taxable year in which paid (and no redetermination shall be made under this section by reason of such payment), and

(II) in any other case, for the taxable year to which such taxes relate, and

(ii) shall be translated as provided in section 986(a)(2)(A).

(3) Adjustments.– The amount of tax (if any) due on any redetermination under paragraph (1) shall be paid by the taxpayer on notice and demand by the Secretary, and the amount of tax overpaid (if any) shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (section 6511 et seq.).

(4) Bond requirements.– In the case of any tax accrued but not paid, the Secretary, as a condition precedent to the allowance of the credit provided in this subpart, may require the taxpayer to give a bond, with sureties satisfactory to and approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination. Any such bond shall contain such further conditions as the Secretary may require.

(5) Other special rules.– In any redetermination under paragraph (1) by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, or deduction under section 164, shall be allowed for any taxable year with respect to any such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period.

Section 906. Nonresident Alien Individuals and Foreign Corporations

(a) Allowance of Credit.– A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

(b) Special Rules.–

(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income from
sources within the United States which would not be taxed by such foreign country or possession but for the fact that—

(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

(2) For purposes of subsection (a), in applying section 904 the taxpayer’s taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer’s conduct of a trade or business within the United States.

(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation.

(5) For purposes of section 902, any income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States shall not be taken into account, and any accumulated profits attributable to such income shall not be taken into account.

(6) No credit shall be allowed under this section against the tax imposed by section 884.

Section 907.
Special Rules in Case of Foreign Oil and Gas Income

(a) Reduction in amount allowed as foreign tax under section 901.— In applying section 901, the amount of any foreign oil and gas taxes paid or accrued (or deemed to have been paid) during the taxable year which would (but for this subsection) be taken into account for purposes of section 901 shall be reduced by the amount (if any) by which the amount of such taxes exceeds the product of—

(1) the amount of the combined foreign oil and gas income for the taxable year,

(2) multiplied by—

(A) in the case of a corporation, the percentage which is equal to the highest rate of tax specified under section 901(a) is taken and the denominator of which is the taxpayer’s entire taxable income.

(b) Combined foreign oil and gas income; foreign oil and gas taxes.— For purposes of this section—

(1) Combined foreign oil and gas income.— The term “combined foreign oil and gas income” means, with respect to any taxable year, the sum of—

(A) foreign oil and gas extraction income, and

(B) foreign oil related income.

(2) Foreign oil and gas taxes.— The term “foreign oil and gas taxes” means, with respect to any taxable year, the sum of—

(A) oil and gas extraction taxes, and

(B) any income, war profits, and excess profits taxes paid or accrued (or deemed to have been paid or accrued under section 902 or 960) during the taxable year with respect to foreign oil related income (determined without regard to subsection (c)(4)) or loss which would be taken into account for purposes of section 901 without regard to this section.

(c) Foreign Income Definitions and Special Rules.— For purposes of this section—

(1) Foreign oil and gas extraction income.— The term “foreign oil and gas extraction income” means the taxable income derived from sources without the United States and its possessions from—

(A) the extraction (by the taxpayer or any other person) of minerals from oil or gas wells, or

(B) the sale or exchange of assets used by the taxpayer in the trade or business described in subparagraph (A).

Such term does not include any dividend or interest income which is passive income (as defined in section 904(d)(2)(A)).

(2) Foreign oil related income.— The term “foreign oil related income” means the taxable income derived from sources outside the United States and its possessions from—

(A) the processing of minerals extracted (by the taxpayer or by any other person) from oil or gas wells into their primary products,

(B) the transportation of such minerals or primary products,

(C) the distribution or sale of such minerals or primary products,
(D) the disposition of assets used by the taxpayer in the trade or business described in subparagraph (A), (B), or (C), or

(E) the performance of any other related service.

Such term does not include any dividend or interest income which is passive income (as defined in section 904(d)(2)(A)).

(3) Dividends, interest, partnership distribution, etc.—The term “foreign oil and gas extraction income” and the term “foreign oil related income” include—

(A) dividends and interest from a foreign corporation in respect of which taxes are deemed paid by the taxpayer under section 902,

(B) amounts with respect to which taxes are deemed paid under section 960(a), and

(C) the taxpayer’s distributive share of the income of partnerships.

to the extent such dividends, interest, amounts, or distributive share is attributable to foreign oil and gas extraction income, or to foreign oil related income, as the case may be; except that interest described in subparagraph (A) shall not be taken into account in computing foreign oil and gas extraction income but shall be taken into account in computing foreign oil-related income.

(4) Recapture of foreign oil and gas losses by recharacterizing later combined foreign oil and gas income.—

(A) In general.—The combined foreign oil and gas income of a taxpayer for a taxable year (determined without regard to this paragraph) shall be reduced—

(i) first by the amount determined under subparagraph (B), and

(ii) then by the amount determined under subparagraph (C).

The aggregate amount of such reductions shall be treated as income (from sources without the United States) which is not combined foreign oil and gas income.

(B) Reduction for pre-2009 foreign oil extraction losses.—The reduction under this paragraph shall be equal to the lesser of—

(i) the foreign oil and gas extraction income of the taxpayer for the taxable year (determined without regard to this paragraph), or

(ii) the excess of—

(I) the aggregate amount of foreign oil extraction losses for preceding taxable years beginning after December 31, 1982, and before January 1, 2009, over

(II) so much of such aggregate amount as was recharacterized under this paragraph (as in effect before and after the date of the enactment of the Energy Improvement and Extension Act of 2008) for preceding taxable years beginning after December 31, 1982.

(C) Reduction for post-2008 foreign oil and gas losses.—The reduction under this paragraph shall be equal to the lesser of—

(i) the combined foreign oil and gas income of the taxpayer for the taxable year (determined without regard to this paragraph), reduced by an amount equal to the reduction under subparagraph (A) for the taxable year, or

(ii) the excess of—

(I) the aggregate amount of foreign oil and gas losses for preceding taxable years beginning after December 31, 2008, over

(II) so much of such aggregate amount as was recharacterized under this paragraph for preceding taxable years beginning after December 31, 2008.

(D) Foreign oil and gas loss defined.—

(i) In general.—For purposes of this paragraph, the term “foreign oil and gas loss” means the amount by which—

(I) the gross income for the taxable year from sources without the United States and its possessions (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) taken into account in determining the combined foreign oil and gas income for such year, is exceeded by

(II) the sum of the deductions properly apportioned or allocated thereto.

(ii) Net operating loss deduction not taken into account.—For purposes of clause (i), the net operating loss deduction allowable for the taxable year under section 172(a) shall not be taken into account.

(iii) Expropriation and casualty losses not taken into account.—For purposes of clause (i), there shall not be taken into account—

(I) any foreign expropriation loss (as defined in section 172(h) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)) for the taxable year, or

(II) any loss for the taxable year which arises from fire, storm, shipwreck, or other casualty, or from theft,
to the extent such loss is not compensated for by insurance or otherwise.

(iv) Foreign oil extraction loss.— For purposes of subparagraph (B)(ii)(I), foreign oil extraction losses shall be determined under this paragraph as in effect on the day before the date of the enactment of the Energy Improvement and Extension Act of 2008.

(4) Recapture of foreign oil and gas losses by recharacterizing later combined foreign oil and gas income.—

(A) In general.— The combined foreign oil and gas income of a taxpayer for a taxable year (determined without regard to this paragraph) shall be reduced—

(i) first by the amount determined under subparagraph (B), and

(ii) then by the amount determined under subparagraph (C).

The aggregate amount of such reductions shall be treated as income (from sources without the United States) which is not combined foreign oil and gas income.

(B) Reduction for pre-2009 foreign oil extraction losses.— The reduction under this paragraph shall be equal to the lesser of—

(i) the foreign oil and gas extraction income of the taxpayer for the taxable year (determined without regard to this paragraph), or

(ii) the excess of—

(I) the aggregate amount of foreign oil extraction losses for preceding taxable years beginning after December 31, 1982, and before January 1, 2009, over

(II) so much of such aggregate amount as was recharacterized under this paragraph as in effect on the day before the date of the enactment of this paragraph for preceding taxable years beginning after December 31, 2008.

(C) Reduction for post-2008 foreign oil and gas losses.— The reduction under this paragraph shall be equal to the lesser of—

(i) the combined foreign oil and gas income of the taxpayer for the taxable year (determined without regard to this paragraph), reduced by an amount equal to the reduction under subparagraph (A) for the taxable year, or

(ii) the excess of—

(I) the aggregate amount of foreign oil and gas losses for preceding taxable years beginning after December 31, 2008, over

(II) so much of such aggregate amount as was recharacterized under this paragraph for preceding taxable years beginning after December 31, 2008.

(D) Foreign oil and gas loss defined.—

(i) In general.— For purposes of this paragraph, the term “foreign oil and gas loss” means the amount by which—

(I) the gross income for the taxable year from sources without the United States and its possessions (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) taken into account in determining the combined foreign oil and gas income for such year, is exceeded by

(II) the sum of the deductions properly apportioned or allocated thereto.

(ii) Net operating loss deduction not taken into account.— For purposes of clause (i), the net operating loss deduction allowable for the taxable year under section 172(a) shall not be taken into account.

(iii) Expropriation and casualty losses not taken into account.— For purposes of clause (i), there shall not be taken into account—

(I) any foreign expropriation loss (as defined in section 172(h) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)) for the taxable year, or

(II) any loss for the taxable year which arises from fire, storm, shipwreck, or other casualty, or from theft,

to the extent such loss is not compensated for by insurance or otherwise.

(iv) Foreign oil extraction loss.— For purposes of subparagraph (B)(ii)(I), foreign oil extraction losses shall be determined under this paragraph as in effect on the day before the date of the enactment of the Energy Improvement and Extension Act of 2008.

(5) Oil and gas extraction taxes.— The term “oil and gas extraction taxes” means any income, war profits, and excess profits tax paid or accrued (or deemed to have been paid under section 902 or 960) during the taxable year with respect to foreign oil and gas extraction income (determined without regard to paragraph (4)) or loss which would be taken into account for purposes of sections 901 without regard to this section.

(d) Disregard of Certain Posted Prices, Etc.— For purposes of this chapter, in determining the amount of taxable income in the case of foreign oil and gas extraction income, if the oil or gas is disposed of, or is acquired other than from the government of a foreign country, at a posted price (or other
Internal Revenue Code

pricing arrangement) which differs from the fair market value for such oil or gas, such fair market value shall be used in lieu of such posted price (or other pricing arrangement).

(c) Transitional rules [Repealed—1990 Rev. Recon. Act, sec. 11801(a)(32)]

(f) Carryback and Carryover of Disallowed Credits—

(1) In general.—If the amount of the foreign oil and gas taxes paid or accrued during any taxable year exceeds the limitation provided by subsection (a) for such taxable year (hereinafter in this subsection referred to as the “unused credit year”), such excess shall be deemed to be foreign oil and gas taxes paid or accrued in the first preceding taxable year and in any of the first 10 succeeding taxable years, in that order and to the extent not deemed tax paid or accrued in a prior taxable year by reason of the limitation imposed by paragraph (2). Such amount deemed paid or accrued in any taxable year may be availed of only as a tax credit and not as a deduction and only if the taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions.

(2) Limitation.—The amount of the unused foreign oil and gas taxes which under paragraph (1) may be deemed paid or accrued in any preceding or succeeding taxable year shall not exceed the lesser of—

(A) the amount by which the limitation provided by subsection (a) for such taxable year exceeds the sum of—

(i) the foreign oil and gas taxes paid or accrued during such taxable year, plus

(ii) the amounts of the foreign oil and gas taxes which by reason of this subsection are deemed paid or accrued in such taxable year and are attributable to taxable years preceding the unused credit year; or

(B) the amount by which the limitation provided by section 904 for such taxable year exceeds the sum of—

(i) the taxes paid or accrued (or deemed to have been paid under section 902 or 960) to all foreign countries and possessions of the United States during such taxable year,

(ii) the amount of such taxes which were deemed paid or accrued in such taxable year under section 904(c) and which are attributable to taxable years preceding the unused credit year, plus

(iii) the amount of the foreign oil and gas taxes which by reason of this subsection are deemed paid or accrued in such taxable year and are attributable to taxable years preceding the unused credit year.

(3) Special rules.—

(A) In the case of any taxable year which is an unused credit year under this subsection and which is an unused credit year under section 904(c), the provisions of this subsection shall be applied before section 904(c).

(B) For purposes of determining the amount of taxes paid or accrued in any taxable year which may be deemed paid or accrued in a preceding or succeeding taxable year under section 904(c), any tax deemed paid or accrued in such preceding or succeeding taxable year under this subsection shall be considered to be tax paid or accrued in such preceding or succeeding taxable year.

(C) [Repealed 1990 Rev. Recon. Act, sec. 11801(a)(32)]

Section 908. Reduction of Credit for Participation in or Cooperation with an International Boycott

(a) In General.—If a person, or a member of a controlled group (within the meaning of section 993(a)(3)) which includes such person, participates in or cooperates with an international boycott during the taxable year (within the meaning of section 999(b)), the amount of the credit allowable under section 901 to such person, or under section 902 or 960 to United States shareholders of such person, for foreign taxes paid during the taxable year shall be reduced by an amount equal to the product of—

(1) the amount of the credit which, but for this section, would be allowed under section 901 for the taxable year, multiplied by

(2) the international boycott factor (determined under section 999).

(b) Application With Sections 275(a)(4) and 78.—Section 275(a)(4) and section 78 shall not apply to any amount of taxes denied credit under subsection (a).

Subpart B—Earned Income of Citizens or Residents of United States §§ 911—912

Section 911. Citizens or Residents of the United States Living Abroad

(a) Exclusion from Gross Income.—At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year—

(1) the foreign earned income of such individual, and
(2) the housing cost amount of such individual.

(b) Foreign Earned Income.—

(1) Definition.— For purposes of this section—

(A) In general.— The term “foreign earned income” with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

(B) Certain amounts not included in foreign earned income.— The foreign earned income for an individual shall not include amounts—

(i) received as a pension or annuity,

(ii) paid by the United States or an agency thereof to an employee of the United States or an agency thereof,

(iii) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of nonexempt trust) or section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or

(iv) received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

(2) Limitation on foreign earned income.—

(A) In general.— The foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate equal to the exclusion amount for the calendar year in which such taxable year begins.

(B) Attribution to year in which services are performed.— For purposes of applying subparagraph (A), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

(C) Treatment of community income.— In applying subparagraph (A) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount which may be excludable from the gross income of such husband and wife under subsection (a)(1) for any taxable year shall equal the amount which would be so excludable if such amounts did not constitute community income.

(D) Exclusion amount.—

(i) In general.— The exclusion amount for any calendar year is the exclusion amount determined in accordance with the following table (as adjusted by clause (ii)):

<table>
<thead>
<tr>
<th>For calendar year:</th>
<th>The exclusion amount is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>$72,000</td>
</tr>
<tr>
<td>1999</td>
<td>74,000</td>
</tr>
<tr>
<td>2000</td>
<td>76,000</td>
</tr>
<tr>
<td>2001</td>
<td>78,000</td>
</tr>
<tr>
<td>2002 and thereafter</td>
<td>80,000</td>
</tr>
</tbody>
</table>

(ii) Inflation adjustment.— In the case of any taxable year beginning in a calendar year after 2007, the $80,000 amount in clause (i) shall be increased by an amount equal to the product of—

(I) such dollar amount, and

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting “2006” for “1992” in subparagraph (B) thereof. [Ed. Note: The adjusted amount is $91,500 for 2010]

(c) Housing Cost Amount.— For purposes of this section—

(1) In general.— The term “housing cost amount” means an amount equal to the excess of—

(A) the housing expenses of an individual for the taxable year, over

(B) an amount equal to the product of—

(i) 16 percent of the salary (computed on a daily basis) of an employee of the United States who is compensated at a rate equal to the annual rate paid for step 1 of grade GS-14, multiplied by

(ii) the number of days of such taxable year within the applicable period described in subparagraph (A) or (B) of subsection (d)(1).

(2) Housing expenses.—

(A) In general.— The term “housing expenses” means the reasonable expenses paid or incurred during the taxable year by or on behalf of an individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. The term—

(i) includes expenses attributable to the housing (such as utilities and insurance), but

(ii) does not include interest and taxes of the kind deductible under section 163 or 164 or any amount allowable as a deduction under section 216(a).

Housing expenses shall not be treated as reasonable to the extent such expenses are lavish or extravagant under the circumstances.

(B) Second foreign household.—
(i) IN GENERAL.—Except as provided in clause (ii), only housing expenses incurred with respect to that abode which bears the closest relationship to the tax home of the individual shall be taken into account under paragraph (1).

(ii) SEPARATE HOUSEHOLD FOR SPOUSE AND DEPENDENTS.—If an individual maintains a separate abode outside the United States for his spouse and dependents and they do not reside with him because of living conditions which are dangerous, unhealthful, or otherwise adverse, then—

(I) the words “if they reside with him” in subparagraph (A) shall be disregarded, and

(II) the housing expenses incurred with respect to such abode shall be taken into account under paragraph (1).

(3) SPECIAL RULES WHERE HOUSING EXPENSES NOT PROVIDED BY EMPLOYER.—

(A) IN GENERAL.—To the extent the housing cost amount of any individual for any taxable year is not attributable to employer provided amounts, such amount shall be treated as a deduction allowable in computing adjusted gross income to the extent of the limitation of subparagraph (B).

(B) LIMITATION.—For purposes of subparagraph (A), the limitation of this subparagraph is the excess of—

(i) the foreign earned income of the individual for the taxable year, over

(ii) the amount of such income excluded from gross income under subsection (a) for the taxable year.

(C) 1-YEAR CARRYOVER OF HOUSING AMOUNTS NOT ALLOWED BY REASON OF SUBPARAGRAPH (B).—

(i) IN GENERAL.—The amount not allowable as a deduction for any taxable year under subparagraph (A) by reason of the limitation of subparagraph (B) shall be treated as a deduction allowable in computing adjusted gross income for the succeeding taxable year (and only for the succeeding taxable year) to the extent of the limitation of clause (ii) for such succeeding taxable year.

(ii) LIMITATION.—For purposes of clause (i), the limitation of this clause for any taxable year is the excess of—

(I) the limitation of subparagraph (B) for such taxable year, over

(II) amounts treated as a deduction under subparagraph (A) for such taxable year.

(D) EMPLOYER PROVIDED AMOUNTS.—For purposes of this paragraph, the term “employer provided amounts” means any amount paid or incurred on behalf of the individual by the individual’s employer which is foreign earned income included in the individual’s gross income for the taxable year (without regard to this section).

(E) FOREIGN EARNED INCOME.—For purposes of this paragraph, an individual’s foreign earned income for any taxable year shall be determined without regard to the limitation of subparagraph (A) of subsection (b)(2).

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED INDIVIDUAL.—The term “qualified individual” means an individual whose tax home is in a foreign country and who is—

(A) a citizen of the United States and establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(B) a citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period.

(2) EARNED INCOME.—

(A) IN GENERAL.—The term “earned income” means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.

(B) TAXPAYER ENGAGED IN TRADE OR BUSINESS.—In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

(3) TAX HOME.—The term “tax home” means, with respect to any individual, such individual’s home for purposes of section 162(a)(2) (relating to traveling expenses while away from home). An individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States.

(4) WAIVER OF PERIOD OF STAY IN FOREIGN COUNTRY.—Notwithstanding paragraph (1), an individual who—

(A) is a bona fide resident of, or is present in, a foreign country for any period,

(B) leaves such foreign country after August 31, 1978—
(i) during any period during which the Secretary determines, after consultation with the Secretary of State or his delegate, that individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions in such foreign country which precluded the normal conduct of business by such individuals, and

(ii) before meeting the requirements of such paragraph (1), and

(C) establishes to the satisfaction of the Secretary that such individual could reasonably have been expected to have met such requirements but for the conditions referred to in clause (i) of subparagraph (B),

shall be treated as a qualified individual with respect to the period described in subparagraph (A) during which he was a bona fide resident of, or was present in, the foreign country and in applying subsections (b)(2)(A) and (c)(1)(B)(ii) with respect to such individual, only the days within such period shall be taken into account.

(5) Test of bona fide residence.— If—

(A) an individual who has earned income from sources within a foreign country submits a statement to the authorities of that country that he is not a resident of that country, and

(B) such individual is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings,

then such individual shall not be considered a bona fide resident of that country for purposes of paragraph (1)(A).

(6) Denial of double benefits.— No deduction or exclusion from gross income under this subtitle or credit against the tax imposed by this chapter (including any credit or deduction for the amount of taxes paid or accrued to a foreign country or possession of the United States) shall be allowed to the extent such deduction, exclusion, or credit is properly allocable to or chargeable against amounts excluded from gross income under subsection (a).

(7) Aggregate benefit cannot exceed foreign earned income.— The sum of the amount excluded under subsection (a) and the amount deducted under subsection (c)(3)(A) for the taxable year shall not exceed the individual’s foreign earned income for such year.

(8) Limitation on income earned in restricted country.—

(A) In general.— If travel (or any transaction in connection with such travel) with respect to any foreign country is subject to the regulations described in subparagraph (B) during any period—

(i) the term “foreign earned income” shall not include any income from sources within such country attributable to services performed during such period,

(ii) the term “housing expenses” shall not include any expenses allocable to such period for housing in such country or for housing of the spouse or dependents of the taxpayer in another country while the taxpayer is present in such country, and

(iii) an individual shall not be treated as a bona fide resident of, or as present in, a foreign country for any day during which such individual was present in such country during such period.

(B) Regulations.— For purposes of this paragraph, regulations are described in this subparagraph if such regulations—

(i) have been adopted pursuant to the Trading With the Enemy Act (50 U.S.C. App. 1 et seq.), or the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.), and

(ii) include provisions generally prohibiting citizens and residents of the United States from engaging in transactions related to travel to, from, or within a foreign country.

(C) Exception.— Subparagraph (A) shall not apply to any individual during any period in which such individual’s activities are not in violation of the regulations described in subparagraph (B).

(9) Regulations.— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing rules—

(A) for cases where a husband and wife each have earned income from sources outside the United States, and

(B) for married individuals filing separate returns.

(e) Election.—

(1) In general.— An election under subsection (a) shall apply to the taxable year for which made and to all subsequent taxable years unless revoked under paragraph (2).

(2) Revocation.— A taxpayer may revoke an election made under paragraph (1) for any taxable year after the taxable year for which such election was made. Except with the consent of the Secretary, any taxpayer who makes such a revocation for any taxable year may not make another election under this section for any subsequent taxable year before the 6th taxable year after the taxable year for which such revocation was made.

(f) Determination of tax liability.—

(1) In general.— If, for any taxable year, any amount is excluded from gross income of a taxpayer under subsection (a), then, notwithstanding sections 1 and 55—
(A) if such taxpayer has taxable income for such taxable year, the tax imposed by section 1 for such taxable year shall be equal to the excess (if any) of—

(i) the tax which would be imposed by section 1 for such taxable year if the taxpayer’s taxable income were increased by the amount excluded under subsection (a) for such taxable year, over

(ii) the tax which would be imposed by section 1 for such taxable year if the taxpayer’s taxable income were equal to the amount excluded under subsection (a) for such taxable year, and

(B) if such taxpayer has a taxable excess (as defined in section 55(b)(1)(A)(ii)) for such taxable year, the amount determined under the first sentence of section 55(b)(1)(A)(i) for such taxable year shall be equal to the excess (if any) of—

(i) the amount which would be determined under such sentence for such taxable year (subject to the limitation of section 55(b)(3)) if the taxpayer’s taxable excess (as so defined) were increased by the amount excluded under subsection (a) for such taxable year, over

(ii) the amount which would be determined under such sentence for such taxable year if the taxpayer’s taxable excess (as so defined) were equal to the amount excluded under subsection (a) for such taxable year.

(2) Special rules.—

(A) Regular tax.— In applying section 1(h) for purposes of determining the tax under paragraph (1)(A)(i) for any taxable year in which, without regard to this subsection, the taxpayer’s net capital gain exceeds taxable income (hereafter in this subparagraph referred to as the capital gain excess)—

(i) the taxpayer’s net capital gain (determined without regard to section 1(h)(11)) shall be reduced (but not below zero) by such capital gain excess,

(ii) the taxpayer’s qualified dividend income shall be reduced by so much of such capital gain excess as exceeds the taxpayer’s net capital gain (determined without regard to section 1(h)(11) and the reduction under clause (i)), and

(iii) adjusted net capital gain, unrecaptured section 1250 gain, and 28-percent rate gain shall each be determined after increasing the amount described in section 1(h)(4)(B) by such capital gain excess.

(B) Alternative minimum tax.— In applying section 55(b)(3) for purposes of determining the tax under paragraph (1)(B)(i) for any taxable year in which, without regard to this subsection, the taxpayer’s net capital gain exceeds the taxable excess (as defined in section 55(b)(1)(A)(ii))—

(i) the rules of subparagraph (A) shall apply, except that such subparagraph shall be applied by substituting “the taxable excess (as defined in section 55(b)(1)(A)(ii))” for “taxable income”, and

(ii) the reference in section 55(b)(3)(B) to the excess described in section 1(h)(1)(B) shall be treated as a reference to such excess as determined under the rules of subparagraph (A) for purposes of determining the tax under paragraph (1)(A)(i).

(C) Definitions.— Terms used in this paragraph which are also used in section 1(h) shall have the respective meanings given such terms by section 1(h), except that in applying subparagraph (B) the adjustments under part VI of subchapter A shall be taken into account.

(g) Cross References.— For administrative and penal provisions relating to the exclusions provided for in this section, see sections 6001, 6011, 6012(c), and the other provisions of subtitle F.

Section 912.
Exemption for Certain Allowances

The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

(1) Foreign areas allowances.— In the case of civilian officers and employees of the Government of the United States, amounts received as allowances or otherwise (but not amounts received as post differentials) under—

(A) chapter 9 of title I of the Foreign Service Act of 1980,

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(2) Cost-of-living allowances.— In the case of civilian officers or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President (or in the case of judicial officers or employees of the United States, in accordance with rules similar to such regulations).
(3) **Peace Corps allowances.**— In the case of an individual who is a volunteer or volunteer leader within the meaning of the Peace Corps Act and members of his family, amounts received as allowances under section 5 or 6 of the Peace Corps Act other than amounts received as—

(A) termination payments under section 5(c) or section 6(1) of such Act,
(B) leave allowances,
(C) if such individual is a volunteer leader training in the United States, allowances to members of his family, and
(D) such portion of living allowances as the President may determine under the Peace Corps Act as constituting basic compensation.

Section 936.
Puerto Rico and Possession Tax Credit

[Ed. Prior to the adoption of H.R. 3448 in August of 1996, section 936 provided U.S. companies operating in Puerto Rico or a U.S. possession with a tax credit under certain circumstances that effectively eliminated all of the U.S. tax on qualifying income derived from those territories. The 1996 act repealed the Section 936 Possessions Tax Credit over a 10-year period (or shorter) for companies currently doing business in U.S. possessions. For other companies, the credit is repealed for taxable years beginning after December 31, 1995. See Section 30A (Puerto Rico Economic Activity Credit). Section 936(h) contains a definition of intangible property income used in Code sections 367(d)(1) and 482.]

(h) **Tax Treatment of Intangible Property Income.**—

(3) **Intangible property income.**— For purposes of this subsection—

(A) in general.— The term “intangible property income” means the gross income of a corporation attributable to any intangible property other than intangible property which has been licensed to such corporation since prior to 1948 and is in use by such corporation on the date of the enactment of this subparagraph.

(B) Intangible property.— The term “intangible property” means any—

(i) patent, invention, formula, process, design, pattern, or know-how;
(ii) copyright, literary, musical, or artistic composition;
(iii) trademark, trade name, or brand name;
(iv) franchise, license, or contract;

(v) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; or

(vi) any similar item,

which has substantial value independent of the services of any individual.

(C) **Exclusion of reasonable profit.**— The term “intangible property income” shall not include any portion of the income from the sale, exchange or other disposition of any product, or from the rendering of services, by a corporation electing the application of this section which is determined by the Secretary to be a reasonable profit on the direct and indirect costs incurred by such electing corporation which are attributable to such income.

Part III—Income from Sources Without the United States
Subpart F—Controlled Foreign Corporations

[§§ 951-964]

Section 951.
Amounts Included in Gross Income of United States Shareholders

(a) **Amounts Included.**—

(1) in general.— If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) his pro rata share (determined under paragraph (2)) of the corporation’s subpart F income for such year,
(ii) his pro rata share (determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975) of the corporation’s previously excluded subpart F income withdrawn from investment in less developed countries for such year, and
(iii) his pro rata share (determined under section 955(a)(3)) of the corporation’s previously excluded subpart F income withdrawn from foreign base company shipping operations for such year,
(B) the amount determined under section 956 with respect to such shareholder for such year (but only to the
(2) **Pro rata share of subpart F income.**— The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount—

(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

(B) the amount of distributions received by any other person during such year as a dividend with respect to such stock, but only to the extent of the dividend which would have been received if the distribution by the corporation had been the amount (i) which bears the same ratio to the subpart F income of such corporation for the taxable year, as (ii) the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire year.

For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved.

(3) **Limitation on pro rata share of previously excluded subpart F income withdrawn from investment.**— For purposes of paragraph (1)(A)(iii), the pro rata share of any United States shareholder of the previously excluded subpart F income withdrawn from investment in foreign base company shipping operations shall not exceed an amount—

(A) which bears the same ratio to his pro rata share of such income withdrawn (as determined under section 955(a)(3)) for the taxable year, as

(B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

(b) **United States Shareholder Defined.**— For purposes of this subpart, the term “United States shareholder” means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

(c) **Coordination with Passive Foreign Investment Company Provisions.**— If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 1293 (relating to current taxation of income from certain passive foreign investment companies), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A).

Section 952.

**Subpart F Income Defined**

(a) **In General.**— For purposes of this subpart, the term “subpart F income” means, in the case of any controlled foreign corporation, the sum of—

(1) insurance income (as defined under section 953),

(2) the foreign base company income (as determined under section 954),

(3) an amount equal to the product of—

(A) the income of such corporation other than income which—

(i) is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person under section 951 (other than by reason of this paragraph), or

(ii) is described in subsection (b),

multiplied by

(B) the international boycott factor (as determined under section 999),

(4) the sum of the amounts of any illegal bribes, kickbacks, or other payments (within the meaning of section 162(c)) paid by or on behalf of the corporation during the taxable year of the corporation directly or indirectly to an official, employee, or agent in fact of a government, and

(5) the income of such corporation derived from any foreign country during any period during which section 901(j) applies to such foreign country.

The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payor were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

(b) **Exclusion of United States income.**— In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a
reduced rate of tax) pursuant to a treaty obligation of the United States. For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account.

(c) Limitation.—

(1) In general.—

(A) Subpart F income limited to current earnings and profits.— For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such taxable year.

(B) Certain prior year deficits may be taken into account.—

(i) In general.— The amount included in the gross income of any United States shareholder under section 951(a)(1)(A)(i) for any taxable year and attributable to a qualified activity shall be reduced by the amount of such shareholder's pro rata share of any qualified deficit.

(ii) Qualified deficit.— The term “qualified deficit” means any deficit in earnings and profits of the controlled foreign corporation for any prior taxable year which began after December 31, 1986, and for which the controlled foreign corporation was a controlled foreign corporation; but only to the extent such deficit—

(I) is attributable to the same qualified activity as the activity giving rise to the income being offset, and

(II) has not previously been taken into account under this subparagraph.

In determining the deficit attributable to qualified activities described in subclause (II) or (III) of clause (iii), deficits in earnings and profits (to the extent not previously taken into account under this section) for taxable years beginning after 1962 and before 1987 also shall be taken into account. In the case of the qualified activity described in clause (iii)(I), the rule of the preceding sentence shall apply, except that “1982” shall be substituted for “1962”.

(iii) Qualified activity.— For purposes of this paragraph, the term “qualified activity” means any activity giving rise to—

(I) foreign base company oil related income,

(II) foreign base company sales income,

(III) foreign base company services income,

(IV) in the case of a qualified insurance company, insurance income or foreign personal holding company income, or

(V) in the case of a qualified financial institution, foreign personal holding company income.

(iv) Pro rata share.— For purposes of this paragraph, the shareholder's pro rata share of any deficit for any prior taxable year shall be determined under rules similar to rules under section 951(a)(2) for whichever of the following yields the smaller share:

(I) the close of the taxable year, or

(II) the close of the taxable year in which the deficit arose.

(v) Qualified insurance company.— For purposes of this subparagraph, the term “qualified insurance company” means any controlled foreign corporation predominantly engaged in the active conduct of an insurance business in the taxable year and in the prior taxable years in which the deficit arose.

(vi) Qualified financial institution.— For purposes of this paragraph, the term “qualified financial institution” means any controlled foreign corporation predominantly engaged in the active conduct of a banking, financing, or similar business in the taxable year and in the prior taxable year in which the deficit arose.

(vii) Special rules for insurance income.—

(I) In general.— An election may be made under this clause to have section 953(a) applied for purposes of this title without regard to the same country exception under paragraph (1)(A) thereof. Such election, once made, may be revoked only with the consent of the Secretary.

(II) Special rules for affiliated groups.— In the case of an affiliated group of corporations (within the meaning of section 1504 but without regard to section 1504(b)(3) and by substituting “more than 50 percent” for “at least 80 percent” each place it appears), no election may be made under subclause (I) for any controlled foreign corporation unless such election is made for all other controlled foreign corporations who are members of such group and who were created or organized under the laws of the same country as such controlled foreign corporation. For purposes of clause (v), in determining whether any controlled corporation described in the preceding sentence is a qualified insurance company, all such corporations shall be treated as 1 corporation.

(C) Certain deficits of member of the same chain of corporations may be taken into account

(i) In general.— A controlled foreign corporation may elect to reduce the amount of its subpart F income for any taxable year which is attributable to any qualified activity by the amount of any deficit in earnings and profits of a qualified chain member for a taxable year ending with (or within) the taxable year of such controlled foreign corporation to the extent such deficit is attributable to such
activity. To the extent any deficit reduces subpart F income under the preceding sentence, such deficit shall not be taken into account under subparagraph (B).

(ii) Qualified chain member.— For purposes of this subparagraph, the term “qualified chain member” means, with respect to any controlled foreign corporation, any other corporation which is created or organized under the laws of the same foreign country as the controlled foreign corporation but only if—

(I) all the stock of such other corporation (other than directors’ qualifying shares) is owned at all times during the taxable year in which the deficit arose (directly or through 1 or more corporations other than the common parent) by such controlled foreign corporation, or

(II) all the stock of such controlled foreign corporation (other than directors’ qualifying shares) is owned at all times during the taxable year in which the deficit arose (directly or through 1 or more corporations other than the common parent) by such other corporation.

(iii) Coordination.— This subparagraph shall be applied after subparagraphs (A) and (B).

(2) Recharacterization in subsequent taxable years.— If the subpart F income of any controlled foreign corporation for any taxable year was reduced by reason of paragraph (1)(A), any excess of the earnings and profits of such corporation for any subsequent taxable year over the subpart F income of such foreign corporation for such taxable year shall be recharacterized as subpart F income under rules similar to the rules applicable under section 904(f)(5).

(b) Special Rules.— For purposes of subsection (a)—

(1) The following provisions of subchapter L shall not apply:

(A) The small life insurance company deduction.

(B) Section 805(a)(5) (relating to operations loss deduction).

(C) Section 832(c)(5) (relating to certain capital losses).

(2) The items referred to in—

(A) section 803(a)(1) (relating to gross amount of premiums and other considerations),

(B) section 803(a)(2) (relating to net decrease in reserves),

(C) section 805(a)(2) (relating to net increase in reserves), and

(D) section 832(b)(4) (relating to premiums earned on insurance contracts),

shall be taken into account only to the extent they are in respect of any reinsurance or the issuing of any insurance or annuity contract described in subsection (a)(1).

(3) All items of income, expenses, losses, and deductions shall be properly allocated or apportioned under regulations prescribed by the Secretary.

(c) Special Rule for Certain Captive Insurance Companies.—

Section 953.
Insurance Income

(a) General Rule.— For purposes of section 952(a)(1), the term “insurance income” means any income which—

(1) is attributable to the issuing (or reinsuring) of any insurance or annuity contract—

(A) in connection with property, liability arising out of activity in, or in connection with the lives or health of residents of, a country other than the country under the laws of which the controlled foreign corporation is created or organized, or

(B) in connection with risks not described in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract described in subparagraph (A), and

(2) would (subject to the modifications provided by paragraphs (1) and (2) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.
(1) In general.—For purposes only of taking into account related person insurance income—

(A) the term “United States shareholder” means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)) any stock of the foreign corporation,

(B) the term “controlled foreign corporation” has the meaning given to such term by section 957(a) determined by substituting “25 percent or more” for “more than 50 percent”, and

(C) the pro rata share referred to in section 951(a)(1)(A)(i) shall be determined under paragraph (5) of this subsection.

(2) Related person insurance income.—For purposes of this subsection, the term “related person insurance income” means any insurance income (within the meaning of subsection (a)) attributable to a policy of insurance or reinsurance with respect to which the person (directly or indirectly) insured is a United States shareholder in the foreign corporation or a related person to such a shareholder.

(3) Exceptions.—

(A) Corporations not held by insureds.—Paragraph (1) shall not apply to any foreign corporation if at all times during the taxable year of such foreign corporation—

(i) less than 20 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

(ii) less than 20 percent of the total value of such corporation,

is owned (directly or indirectly under the principles of section 883(c)(4)) by persons who are (directly or indirectly) insured under any policy of insurance or reinsurance issued by such corporation or who are related persons to any such person.

(B) De minimis exception.—Paragraph (1) shall not apply to any foreign corporation for a taxable year of such corporation if the related person insurance income (determined on a gross basis) of such corporation for such taxable year is less than 20 percent of its insurance income (as so determined) for such taxable year determined without regard to those provisions of subsection (a)(1) which limit insurance income to income from countries other than the country in which the corporation was created or organized.

(C) Election to treat income as effectively connected.—Paragraph (1) shall not apply to any foreign corporation for any taxable year if—

(i) such corporation elects (at such time and in such manner as the Secretary may prescribe)—

(I) to treat its related person insurance income for such taxable year as income effectively connected with the conduct of a trade or business in the United States, and

(II) to waive all benefits (other than with respect to section 884) with respect to related person insurance income granted by the United States under any treaty between the United States and any foreign country, and

(ii) such corporation meets such requirements as the Secretary shall prescribe to ensure that the tax imposed by this chapter on such income is paid.

An election under this subparagraph made for any taxable year shall not be effective if the corporation (or any predecessor thereof) was a disqualified corporation for the taxable year for which the election was made or for any prior taxable year beginning after 1986.

(D) Special rules for subparagraph (C).—

(i) Period during which election in effect.—

(I) In general.—Except as provided in subclause (II), any election under subparagraph (C) shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(II) Termination.—If a foreign corporation which made an election under subparagraph (C) for any taxable year is a disqualified corporation for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(ii) Exemption from tax imposed by section 4371.—The tax imposed by section 4371 shall not apply with respect to any related person insurance income treated as effectively connected with the conduct of a trade or business within the United States under subparagraph (C).

(E) Disqualified corporation.—For purposes of this paragraph the term “disqualified corporation” means, with respect to any taxable year, any foreign corporation which is a controlled foreign corporation for an uninterrupted period of 30 days or more during such taxable year (determined without regard to this subsection) but only if a United States shareholder (determined without regard to this subsection) owns (within the meaning of section 958(a)) stock in such corporation at some time during such taxable year.

(4) Treatment of mutual insurance companies.—In the case of a mutual insurance company—

(A) this subsection shall apply,

(B) policyholders of such company shall be treated as shareholders, and
(C) appropriate adjustments in the application of this subpart shall be made under regulations prescribed by the Secretary.

(5) Determination of pro rata share.—

(A) In general.—The pro rata share determined under this paragraph for any United States shareholder is the lesser of—

(i) the amount which would be determined under paragraph (2) of section 951(a) if—

(I) only related person insurance income were taken into account,

(II) stock owned (within the meaning of section 958(a)) by United States shareholders on the last day of the taxable year were the only stock in the foreign corporation, and

(III) only distributions received by United States shareholders were taken into account under subparagraph (B) of such paragraph (2), or

(ii) the amount which would be determined under paragraph (2) of section 951(a) if the entire earnings and profits of the foreign corporation for the taxable year were subpart F income.

(B) Coordination with other provisions.—The Secretary shall prescribe regulations providing for such modifications to the provisions of this subpart as may be necessary or appropriate by reason of subparagraph (A).

(6) Related person.—For purposes of this subsection—

(A) In general.—Except as provided in subparagraph (B), the term “related person” has the meaning given such term by section 954(d)(3).

(B) Treatment of certain liability insurance policies.—In the case of any policy of insurance covering liability arising from services performed as a director, officer, or employee of a corporation or as a partner or employee of a partnership, the person performing such services and the entity for which such services are performed shall be treated as related persons.

(7) Coordination with section 1248.—For purposes of section 1248, if any person is (or would be but for paragraph (3)) treated under paragraph (1) as a United States shareholder with respect to any foreign corporation which would be taxed under subchapter L if it were a domestic corporation and which is (or would be but for paragraph (3)) treated under paragraph (1) as a controlled foreign corporation—

(A) such person shall be treated as meeting the stock ownership requirements of section 1248(a)(2) with respect to such foreign corporation, and

(B) such foreign corporation shall be treated as a controlled foreign corporation.

(8) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(A) regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise, and

(B) regulations which may provide that a person will not be treated as a United States shareholder under paragraph (1) with respect to any foreign corporation if neither such person (nor any related person to such person) is (directly or indirectly) insured under any policy of insurance or reinsurance issued by such foreign corporation.

(d) Election by Foreign Insurance Company to Be Treated as Domestic Corporation.—

(1) In general.—If—

(A) a foreign corporation is a controlled foreign corporation (as defined in section 957(a) by substituting “25 percent or more” for “more than 50 percent” and by using the definition of United States shareholder under 953(c)(1)(A)),

(B) such foreign corporation would qualify under part I or II of subchapter L for the taxable year if it were a domestic corporation,

(C) such foreign corporation meets such requirements as the Secretary shall prescribe to ensure that the taxes imposed by this chapter on such foreign corporation are paid, and

(D) such foreign corporation makes an election to have this paragraph apply and waives all benefits to such corporation granted by the United States under any treaty, for purposes of this title, such corporation shall be treated as a domestic corporation.

(2) Period during which election is in effect.—

(A) In general.—Except as provided in subparagraph (B), an election under paragraph (1) shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(B) Termination.—If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraphs (A), (B), and (C), of paragraph (1) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(3) Treatment of losses.—If any corporation treated as a domestic corporation under this subsection is treated as a member of an affiliated group for purposes of chapter 6 (relating to consolidated returns), any loss of such corporation shall be treated as a dual consolidated loss for purposes of section 1503(d) without regard to paragraph (2)(B) thereof.
(4) **Effect of election.–**

(A) **In general.–** For purposes of section 367, any foreign corporation making an election under paragraph (1) shall be treated as transferring (as of the 1st day of the 1st taxable year to which such election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.

(B) **Exception for pre-1988 earnings and profit.–**

(i) **In general.–** Earnings and profits of the foreign corporation accumulated in taxable years beginning before January 1, 1988, shall not be included in the gross income of the persons holding stock in such corporation by reason of subparagraph (A).

(ii) **Treatment of distributions.–** For purposes of this title, any distribution made by a corporation to which an election under paragraph (1) applies out of earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be treated as a distribution made by a foreign corporation.

(iii) **Certain rules to continue to apply to pre-1988 earnings.–** The provisions specified in clause (iv) shall be applied without regard to paragraph (1), except that, in the case of a corporation to which an election under paragraph (1) applies, only earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be taken into account.

(iv) **Specified provisions.–** The provisions specified in this clause are:

(I) Section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporations).

(II) Subpart F of part III of subchapter N to the extent such subpart relates to earnings invested in United States property or amounts referred to in clause (ii) or (iii) of section 951(a)(1)(A).

(III) Section 884 to the extent the foreign corporation reinvested 1987 earnings and profits in United States assets.

(5) **Effect of termination.–** For purposes of section 367, if—

(A) an election is made by a corporation under paragraph (1) for any taxable year, and

(B) such election ceases to apply for any subsequent taxable year,

such corporation shall be treated as a domestic corporation transferring (as of the 1st day of such subsequent taxable year) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.

(6) **Additional tax on corporation making election.–**

(A) **In general.–** If a corporation makes an election under paragraph (1), the amount of tax imposed by this chapter for the 1st taxable year to which such election applies shall be increased by the amount determined under subparagraph (B).

(B) **Amount of tax.–** The amount of tax determined under this paragraph shall be equal to the lesser of—

(i) $3/4 of 1 percent of the aggregate amount of capital and accumulated surplus of the corporation as of December 31, 1987, or

(ii) $1,500,000.

(e) **Exempt insurance income.–** For purposes of this section—

(1) **Exempt insurance income defined.–**

(A) **In general.–** The term "exempt insurance income" means income derived by a qualifying insurance company which—

(i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and

(ii) is treated as earned by such company or branch in its home country for purposes of such country's tax laws.

(B) **Exception for certain arrangements.–** Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.

(C) **Determination made separately.–** For purposes of this subsection and section 954(i), the exempt insurance income and exempt contracts of a qualifying insurance company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—

(i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and

(ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such branch.

(2) **Exempt contract.–**

(A) **In general.–** The term "exempt contract" means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance
company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.

(B) Minimum home country income required.—

(i) In general.— No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—

(1) which cover applicable home country risks, and

(2) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)).

(ii) Applicable home country risks.— The term “applicable home country risks” means risks in connection with property in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.

(C) Substantial activity requirements for cross border risks.— A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—

(i) conducts substantial activity with respect to an insurance business in its home country, and

(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.

(3) Qualifying insurance company.— The term “qualifying insurance company” means any controlled foreign corporation which—

(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country,

(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by such controlled foreign corporation and each of its qualifying insurance company branches of contracts—

(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and

(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)), except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country’s tax laws, and

(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(4) Qualifying insurance company branch.— The term “qualifying insurance company branch” means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—

(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country, and

(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

(5) Life insurance or annuity contract.— For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

(A) such contract is regulated as a life insurance or annuity contract by the corporation’s or unit’s home country, and

(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

(6) Home country.— For purposes of this subsection, except as provided in regulations—

(A) Controlled foreign corporation.— The term “home country” means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.

(B) Qualified business unit.— The term “home country” means, with respect to a qualified business unit (as defined in section 989(a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954(d)(3)) in such country.
(7) **Anti-abuse rules.**— For purposes of applying this subsection and section 954(i)—

(A) the rules of section 954(h)(7) (other than subparagraph (B) thereof) shall apply,

(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,

(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954(i),

(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—

(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or

(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and file such reports, with respect to such contract as the Secretary may require,

(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and

(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954(d)(3)).

For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.

(8) **Coordination with subsection (c).**— In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

(9) **Regulations.**— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954(i).

(10) **Application.**— This subsection and section 954(i) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2010, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after December 31, 2009 (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.

(11) **Cross reference.**— For income exempt from foreign personal holding company income, see section 954(i).

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**Section 954. Foreign Base Company Income**

(a) **Foreign Base Company Income.**— For purposes of section 952(a)(2), the term “foreign base company income” means for any taxable year the sum of—

(1) the foreign personal holding company income for the taxable year (determined under subsection (c) and reduced as provided in subsection (b)(5)),

(2) the foreign base company sales income for the taxable year (determined under subsection (d) and reduced as provided in subsection (b)(5)),

(3) the foreign base company services income for the taxable year (determined under subsection (e) and reduced as provided in subsection (b)(5)),

(4) the foreign base company oil related income for the taxable year (determined under subsection (g) and reduced as provided in subsection (b)(5)).

(b) **Exclusion and Special Rules.**—

(1) [Repealed]

(2) [Repealed]

(3) **De minimis, etc., rules.**— For purposes of subsection (a) and section 953—

(A) **De minimis rule.**— If the sum of foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year is less than the lesser of—

(i) 5 percent of gross income, or

(ii) $1,000,000,

no part of the gross income for the taxable year shall be treated as foreign base company income or insurance income.

(B) **Foreign base company income and insurance income in excess of 70 percent of gross income.**— If the sum of the foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall,
subject to the provisions of paragraphs (4) and (5), be treated as foreign base company income or insurance income (whichever is appropriate).

(C) Gross insurance income.—For purposes of subparagraphs (A) and (B), the term “gross insurance income” means any item of gross income taken into account in determining insurance income under section 953.

(4) Exception for certain income subject to high foreign taxes.—For purposes of subsection (a) and section 953, foreign base company income and insurance income shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11. The preceding sentence shall not apply to foreign base company oil-related income described in subsection (a)(5).

(5) Deductions to be taken into account.—For purposes of subsection (a), the foreign personal holding company income, the foreign base company sales income, the foreign base company services income, and the foreign base company oil related income shall be reduced, under regulations prescribed by the Secretary so as to take into account deductions (including taxes) properly allocable to such income. Except to the extent provided in regulations prescribed by the Secretary, any interest which is paid or accrued by the controlled foreign corporation to any United States shareholder in such corporation (or any controlled foreign corporation related to such a shareholder) shall be allocated first to foreign personal holding company income which is passive income (within the meaning of section 904(d)(2)) of such corporation to the extent thereof. The Secretary may, by regulations, provide that the preceding sentence shall apply also to interest paid or accrued to other persons.

(6) Foreign base company oil related income not treated as another kind of base company income.—Income of a corporation which is foreign base company oil related income shall not be considered foreign base company income of such corporation under paragraph (2), or (3) of subsection (a).

[Foreign Personal Holding Company Income]

(c) Foreign Personal Holding Company Income.—

(1) In general.—For purposes of subsection (a)(1), the term “foreign personal holding company income” means the portion of the gross income which consists of:

(A) Dividends, etc.—Dividends, interest, royalties, rents, and annuities.

(B) Certain property transactions.—The excess of gains over losses from the sale or exchange of property—

(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)) other than property which gives rise to income not treated as foreign personal holding company income by reason of subsection (h) or (i) for the taxable year,

(ii) which is an interest in a trust, partnership, or REMIC, or

(iii) which does not give rise to any income.

Gains and losses from the sale or exchange of any property which, in the hands of the controlled foreign corporation, is property described in section 1221(a)(1) shall not be taken into account under this subparagraph.

(C) Commodities Transactions.—The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. This subparagraph shall not apply to gains or losses which—

(i) arise out of commodity hedging transactions (as defined in paragraph (5)(A)),

(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation’s commodities are property described in paragraph (1), (2), or (8) of section 1221(a), or

(iii) are foreign currency gains or losses (as defined in section 988(b)) attributable to any section 988 transactions.

(D) Foreign Currency Gains.—The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions. This subparagraph shall not apply in the case of any transaction directly related to the business needs of the controlled foreign corporation.

(E) Income Equivalent to Interest.—Any income equivalent to interest, including income from commitment fees (or similar amounts) for loans actually made.

(F) Income from Notional Principal Contracts.—

(i) In general.—Net income from notional principal contracts.

(ii) Coordination with other categories of foreign personal holding company income.—Any item of income, gain, deduction, or loss from a notional principal contract entered into for purposes of hedging any item described in any preceding subparagraph shall not be taken into account for purposes of this subparagraph but shall be taken into account under such other subparagraph.
(G) Payments in lieu of dividends.— Payments in lieu of dividends which are made pursuant to an agreement to which section 1058 applies.

(H) Personal service contracts.—

(i) Amounts received under a contract under which the corporation is to furnish personal services if—

(I) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or

(II) the individual who is to perform the services is designated (by name or by description) in the contract, and

(ii) amounts received from the sale or other disposition of such a contract. This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(2) Exception for certain amounts.—

(A) Rents and royalties derived in active business.— Foreign personal holding company income shall not include rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)). For purposes of the preceding sentence, rents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined under regulations prescribed by the Secretary, the active leasing expenses are not less than 10 percent of the profit on the lease.

(B) Certain export financing.— Foreign personal holding company income shall not include any interest which is derived in the conduct of a banking business and which is export financing interest (as defined in section 904(d)(2)(G)).

(C) Exception for Dealers.— Except as provided by regulations, in the case of a regular dealer in property which is property described in paragraph (1)(B), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), there shall not be taken into account in computing foreign personal holding company income—

(i) any item of income, gain, deduction, or loss (other than any item described in subparagraph (A), (E), or (G) of paragraph (1)) from any transaction (including hedging transactions and transactions involving physical settlement) entered into in the ordinary course of such dealer’s trade or business as such a dealer, and

(ii) if such dealer is a dealer in securities (within the meaning of section 475), any interest or dividend or equivalent amount described in subparagraph (E) or (G) of paragraph (1) from any transaction (including any hedging transaction or transaction described in section 956(c)(2)(I)) entered into in the ordinary course of such dealer’s trade or business as such a dealer in securities, but only if the income from the transaction is attributable to activities of the dealer in the country under the laws of which the dealer is created or organized (or in the case of a qualified business unit described in section 989(a), is attributable to activities of the unit in the country in which the unit both maintains its principal office and conducts substantial business activity).

(3) Certain income received from related persons.—

(A) In general.— Except as provided in subparagraph (B), the term “foreign personal holding company income” does not include—

(i) dividends and interest received from a related person which which (I) is a corporation created or organized under the laws of the same foreign country under the laws of which the controlled foreign corporation is created or organized, and (II) has a substantial part of its assets used in its trade or business located in such same foreign country, and

(ii) rents and royalties received from a corporation which is a related person for the use of, or the privilege of using, property within the country under the laws of which the controlled foreign corporation is created or organized.

To the extent provided in regulations, payments made by a partnership with 1 or more corporate partners shall be treated as made by such corporate partners in proportion to their respective interests in the partnership.

(B) Exception not to apply to items which reduce subpart F income.— Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty reduces the payor’s subpart F income or creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) Exception for certain dividends.— Subparagraph (A)(i) shall not apply to any dividend with respect to any stock which is attributable to earnings and profits of the distributing corporation accumulated during any period during which the person receiving such dividend did not hold such stock either directly, or indirectly through a

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chain of one or more subsidiaries each of which meets the requirements of subparagraph (A)(i).

(4) Look-thru rule for certain partnership sales.–

(A) In general.– In the case of any sale by a controlled foreign corporation of an interest in a partnership with respect to which such corporation is a 25-percent owner, such corporation shall be treated for purposes of this subsection as selling the proportionate share of the assets of the partnership attributable to such interest. The Secretary shall prescribe such regulations as may be appropriate to prevent abuse of the purposes of this paragraph, including regulations providing for coordination of this paragraph with the provisions of subchapter K.

(B) 25-percent owner.– For purposes of this paragraph, the term “25-percent owner” means a controlled foreign corporation which owns directly 25 percent or more of the capital or profits interest in a partnership. For purposes of the preceding sentence, if a controlled foreign corporation is a partner of a corporation or partnership, the controlled foreign corporation shall be treated as owning directly its proportionate share of any such capital or profits interest held directly or indirectly by such corporation or partnership. If a controlled foreign corporation is treated as owning a capital or profits interest in a partnership under constructive ownership rules similar to the rules of section 958(b), the controlled foreign corporation shall be treated as owning such interest directly for purposes of this subparagraph. If a controlled foreign corporation is treated as owning a capital or profits interest in a partnership under constructive ownership rules similar to the rules of section 958(b), the controlled foreign corporation shall be treated as owning such interest directly for purposes of this subparagraph.

(5) Definition and special rules relating to commodity transactions.–

(A) Commodity hedging transactions.– For purposes of paragraph (1)(C)(i), the term “commodity hedging transaction” means any transaction with respect to a commodity if such transaction—

(i) is a hedging transaction as defined in section 1221(b)(2), determined—

(I) without regard to subparagraph (A)(ii) thereof,

(II) by applying subparagraph (A)(i) thereof by substituting “ordinary property or property described in section 1231(b)” for “ordinary property”, and

(III) by substituting “controlled foreign corporation” for “taxpayer” each place it appears, and

(ii) is clearly identified as such in accordance with section 1221(a)(7).

(B) Treatment of dealer activities under paragraph (1)(C).– Commodities with respect to which gains and losses are not taken into account under paragraph (2)(C) in computing a controlled foreign corporation’s foreign personal holding company income shall not be taken into account in applying the substantially all test under paragraph (1)(C)(ii) to such corporation.

(C) Regulations.– The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (1)(C) in the case of transactions involving related parties.

(6) Look-thru rule for related controlled foreign corporations.–

(A) In general.– For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including such regulations as may be necessary or appropriate to prevent the abuse of the purposes of this paragraph.

(B) Exception.– Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) Application.– Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2010, and to taxable years of United States shareholders within which such taxable years of foreign corporations end.

[Foreign Base Company Sales Income]

(d) Foreign Base Company Sales Income.–

(1) In general.– For purposes of subsection (a)(2), the term “foreign base company sales income” means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of
personal property from any person on behalf of a related person where—

(A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, and

(B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

For purposes of this subsection, personal property does not include agricultural commodities which are not grown in the United States in commercially marketable quantities.

[Branch Rule]

(2) Certain branch income.—For purposes of determining foreign base company sales income in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, under regulations prescribed by the Secretary the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

[Definition of Related Person]

(3) Related person defined.—For purposes of this section, a person is a related person with respect to a controlled foreign corporation, if—

(A) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power of all classes of stock entitled to vote or of the total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of more than 50 percent (by value) of the beneficial interests in such partnership, trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply.

(4) Special rule for certain timber products.—For purposes of subsection (a)(2), the term “foreign base company sales income” includes any income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with—

(A) the sale of any unprocessed timber referred to in section 865(b), or

(B) the milling of any such timber outside the United States.

Subpart G shall not apply to any amount treated as subpart F income by reason of this paragraph.

[Foreign Base Company Services Income]

(e) Foreign Base Company Services Income.—

(1) In general.—For purposes of subsection (a)(3), the term “foreign base company services income” means income (whether in the form of compensation, commissions, fees, or otherwise) derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

(A) are performed for or on behalf of any related person (within the meaning of subsection (d)(3)), and

(B) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

(2) Exception.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange, or

(B) an offer or effort to sell or exchange such property.

Paragraph (1) shall also not apply to income which is exempt insurance income (as defined in section 953(e)) or which is not treated as foreign personal holding income by reason of subsection (c)(2)(C)(ii), (h), or (i).

[Foreign Base Company Oil Related Income]

(g) Foreign Base Company Oil Related Income.—For purposes of this section—

(1) In general.—Except as otherwise provided in this subsection, the term “foreign base company oil related income” means foreign oil related income (within the meaning of paragraphs (2) and (3) of section 907(c)) other than income derived from a source within a foreign country in connection with—

(A) oil or gas which was extracted from an oil or gas well located in such foreign country, or
(B) oil, gas, or a primary product of oil or gas which is sold by the foreign corporation or a related person for use or consumption within such country or is loaded in such country on a vessel or aircraft as fuel for such vessel or aircraft.

Such term shall not include any foreign personal holding company income (as defined in subsection (c)).

(2) Paragraph (1) applies only where corporation has produced 1,000 barrels per day or more

(A) In general.– The term “foreign base company oil related income” shall not include any income of a foreign corporation if such corporation is not a large oil producer for the taxable year.

(B) Large oil producer.– For purposes of subparagraph (A), the term “large oil producer” means any corporation if, for the taxable year or for the preceding taxable year, the average daily production of foreign crude oil and natural gas of the related group which includes such corporation equaled or exceeded 1,000 barrels.

(C) Related group.– The term “related group” means a group consisting of the foreign corporation and any other person who is a related person with respect to such corporation.

(D) Average daily production of foreign crude oil and natural gas.– For purposes of this paragraph, the average daily production of foreign crude oil or natural gas of any related group for any taxable year (and the conversion of cubic feet of natural gas into barrels) shall be determined under rules similar to the rules of section 613A except that only crude oil or natural gas from a well located outside the United States shall be taken into account.

(h) Special Rule for Income Derived in the Active Conduct of Banking, Financing, or Similar Businesses.–

(1) In general.– For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified banking or financing income of an eligible controlled foreign corporation.

(2) Eligible Controlled Foreign Corporation.– For purposes of this subsection—

(A) In general.– The term “eligible controlled foreign corporation” means a controlled foreign corporation which—

(i) is predominantly engaged in the active conduct of a banking, financing, or similar business if—

(I) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,

(II) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or

(iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations), or

(B) Predominantly Engaged.– A controlled foreign corporation shall be treated as predominantly engaged in the active conduct of a banking, financing, or similar business if—

(i) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,

(ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or

(iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations).

(B) Limitation on Nonbanking and Nonsecurities Businesses.– No income of an eligible controlled foreign corporation not described in clause (ii) or (iii) of paragraph (2)(B) (or of a qualified business unit of such corporation) shall be treated as qualified banking or financing income unless more than 30 percent of such corporation’s or unit’s gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons and which are located within such corporation’s or unit’s home country.
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(C) **Substantial Activity Requirement for Cross Border Income.**—The term ‘qualified banking or financing income’ shall not include income derived from 1 or more transactions with customers located in a country other than the home country of the eligible controlled foreign corporation or a qualified business unit of such corporation unless such corporation or unit conducts substantial activity with respect to a banking, financing, or similar business in its home country.

(D) **Determinations Made Separately.**—For purposes of this paragraph, the qualified banking or financing income of an eligible controlled foreign corporation and each qualified business unit of such corporation shall be determined separately for such corporation and each such unit by taking into account—

(i) in the case of the eligible controlled foreign corporation, only items of income, deduction, gain, or loss and activities of such corporation not properly allocable or attributable to any qualified business unit of such corporation, and

(ii) in the case of a qualified business unit, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

(E) **Direct Conduct of Activities.**—For purposes of subparagraph (A)(ii)(II), an activity shall be treated as conducted directly by an eligible controlled foreign corporation or qualified business unit in its home country if the activity is performed by employees of a related person and—

(i) the related person is an eligible controlled foreign corporation the home country of which is the same as the home country of the corporation or unit to which subparagraph (A)(ii)(II) is being applied,

(ii) the activity is performed in the home country of the related person, and

(iii) the related person is compensated on an arm’s-length basis for the performance of the activity by its employees and such compensation is treated as earned by such person in its home country for purposes of the home country’s tax laws.

(4) **Lending or Finance Business.**—For purposes of this subsection, the term ‘lending or finance business’ means the business of—

(A) making loans,

(B) purchasing or discounting accounts receivable, notes, or installment obligations,

(C) engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets),

(D) issuing letters of credit or providing guarantees,

(E) providing charge and credit card services, or

(F) rendering services or making facilities available in connection with activities described in subparagraphs (A) through (E) carried on by—

(i) the corporation (or qualified business unit) rendering services or making facilities available, or

(ii) another corporation (or qualified business unit of a corporation) which is a member of the same affiliated group (as defined in section 1504, but determined without regard to section 1504(b)(3)).

(5) **Other Definitions.**—For purposes of this subsection—

(A) **Customer.**—The term ‘customer’ means, with respect to any controlled foreign corporation or qualified business unit, any person which has a customer relationship with such corporation or unit and which is acting in its capacity as such.

(B) **Home Country.**—Except as provided in regulations—

(i) **Controlled Foreign Corporation.**—The term ‘home country’ means, with respect to any controlled foreign corporation, the country under the laws of which the corporation was created or organized.

(ii) **Qualified Business Unit.**—The term ‘home country’ means, with respect to any qualified business unit, the country in which such unit maintains its principal office.

(C) **Located.**—The determination of where a customer is located shall be made under rules prescribed by the Secretary.

(D) **Qualified Business Unit.**—The term ‘qualified business unit’ has the meaning given such term by section 989(a).

(E) **Related Person.**—The term ‘related person’ has the meaning given such term by subsection (d)(3).

(6) **Coordination With Exception For Dealers.**—Paragraph (1) shall not apply to income described in subsection (c)(2)(C)(ii) of a dealer in securities (within the meaning of section 475) which is an eligible controlled foreign corporation described in paragraph (2)(B)(iii).

(7) **Anti-abuse Rules.**—For purposes of applying this subsection and subsection (c)(2)(C)(ii)—

(A) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions one of the principal purposes of which is qualifying income or gain for the exclusion under this section, including any transaction or series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of such exclusion through the application of this subsection,
(B) there shall be disregarded any item of income, gain, loss, or deduction of an entity which is not engaged in regular and continuous transactions with customers which are not related persons,

(C) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions utilizing, or doing business with–

(i) one or more entities in order to satisfy any home country requirement under this subsection, or

(ii) a special purpose entity or arrangement, including a securitization, financing, or similar entity or arrangement, if one of the principal purposes of such transaction or series of transactions is qualifying income or gain for the exclusion under this subsection, and

(D) a related person, an officer, a director, or an employee with respect to any controlled foreign corporation (or qualified business unit) which would otherwise be treated as a customer of such corporation or unit with respect to any transaction shall not be so treated if a principal purpose of such transaction is to satisfy any requirement of this subsection.

(8) Regulations.– The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, subsection (c)(1)(B)(i), subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2).

(9) Application.– This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2010, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.

(i) Special Rule for Income Derived in the Active Conduct of Insurance Business.–

(1) in General.– For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified insurance income of a qualifying insurance company.

(2) Qualified Insurance Income.– The term ‘qualified insurance income’ means income of a qualifying insurance company which is–

(A) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from investments made by a qualifying insurance company or a qualifying insurance company branch of an amount of its assets allocable to exempt contracts equal to–

(i) in the case of property, casualty, or health insurance contracts, one-third of its premiums earned on such insurance contracts during the taxable year (as defined in section 832(b)(4)), and

(ii) in the case of life insurance or annuity contracts, 10 percent of the reserves described in subparagraph (A) for such contracts.

(3) Principles for Determining Insurance Income.– Except as provided by the Secretary, for purposes of subparagraphs (A) and (B) of paragraph (2)–

(A) in the case of any contract which is a separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract shall be allocable only to such contract, and

(B) income not allocable under subparagraph (A) shall be allocated ratably among contracts not described in subparagraph (A).

(4) Methods for Determining Unearned Premiums and Reserves.– For purposes of paragraph (2)(A)–

(A) Property and Casualty Contracts.– The unearned premiums and reserves of a qualifying insurance company or a qualifying insurance company branch with respect to property, casualty, or health insurance contracts shall be determined using the same methods and interest rates which would be used if such company or branch were subject to tax under subchapter L, except that–

(i) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate, and

(ii) such company or branch shall use the appropriate foreign loss payment pattern.

(B) Life Insurance And Annuity Contracts.– The amount of the reserve of a qualifying insurance company or qualifying insurance company branch for any life insurance or annuity contract shall be equal to the greater of–

(i) the net surrender value of such contract (as defined in section 807(e)(1)(A)), or

(ii) the reserve determined under paragraph (5).

(C) Limitation on Reserves.– In no event shall the reserve determined under this paragraph for any contract
as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining foreign statement reserves (less any catastrophe, deficiency, equalization, or similar reserves).

(5) **Amount of Reserve.**—The amount of the reserve determined under this paragraph with respect to any contract shall be determined in the same manner as it would be determined if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L, except that in applying such subchapter—

(A) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate,

(B) the highest assumed interest rate permitted to be used in determining foreign statement reserves shall be substituted for the prevailing State assumed interest rate,

(C) tables for mortality and morbidity which reasonably reflect the current mortality and morbidity risks in the company’s or branch’s home country shall be substituted for the mortality and morbidity tables otherwise used for such subchapter.

The Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for 1 or more of its qualifying insurance company branches when appropriate.

(6) **Definitions.**—For purposes of this subsection, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term by section 953.

**Section 955.**

**Withdrawal of Previously Excluded Subpart F Income from Qualified Investment**

(a) **General Rules.**—

(1) **Amount withdrawn.**—For purposes of this subpart, the amount of previously excluded subpart F income of any controlled foreign corporation withdrawn from investment in foreign base company shipping operations for any taxable year is an amount equal to the decrease in the amount of qualified investments in foreign base company shipping operations of the controlled foreign corporation for such year, but only to the extent that the amount of such decrease does not exceed an amount equal to—

(A) the sum of the amounts excluded under section 954(b)(2) from the foreign base company income of such corporation for all prior taxable years beginning before 1987, reduced by

(B) the sum of the amounts of previously excluded subpart F income withdrawn from investment in foreign base company shipping operations of such corporation determined under paragraph (1) for any taxable year, is the amount by which—

(A) the amount of qualified investments in foreign base company shipping operations of the controlled foreign corporation as of the close of the last taxable year beginning before 1987 (to the extent such amount exceeds the sum of the decreases in qualified investments determined under this paragraph for prior taxable years beginning after 1986), exceeds

(B) the amount of qualified investments in foreign base company shipping operations of the controlled foreign corporation at the close of the taxable year, to the extent that the amount of such decrease does not exceed the sum of the earnings and profits for the taxable year and the earnings and profits accumulated for prior taxable years beginning after December 31, 1975, and the amount of previously excluded subpart F income invested in less developed country corporations described in section 955(c)(2) (as in effect before the enactment of the Tax Reduction Act of 1975) to the extent attributable to earnings and profits accumulated for taxable years beginning after December 31, 1962. For purposes of this paragraph, if qualified investments in foreign base company shipping operations are disposed of by the controlled foreign corporation during the taxable year, the amount of the decrease in qualified investments in foreign base company shipping operations of such controlled foreign corporations for such year shall be reduced by an amount equal to the amount (if any) by which the losses on such dispositions during such year exceed the gains on such dispositions during such year.

(3) **Pro rata share of amount withdrawn.**—In the case of any United States shareholder, the pro rata share of the amount of previously excluded subpart F income of any controlled foreign corporation withdrawn from investment in foreign base company shipping operations of such corporation for any taxable year is the pro rata share of the amount determined under paragraph (1).

(b) **Qualified Investments in Foreign Base Company Shipping Operations.**—
(1) In general.— For purposes of this subpart, the term “qualified investments in foreign base company shipping operations” means investments in—

(A) any aircraft or vessel used in foreign commerce, and
(B) other assets which are used in connection with the performance of services directly related to the use of any such aircraft or vessel.

Such term includes, but is not limited to, investments by a controlled foreign corporation in stock or obligations of another controlled foreign corporation which is a related person (within the meaning of section 954(d)(3)) and which holds assets described in the preceding sentence, but only to the extent that such assets are so used.

(2) Qualified investments by related persons.— For purposes of determining the amount of qualified investments in foreign based company shipping operations, an investment (or a decrease in investment) in such operations by one or more controlled foreign corporations may, under regulations prescribed by the Secretary, be treated as an investment (or a decrease in investment) by another corporation which is a controlled foreign corporation and is a related person (as defined in section 954(d)(3) with respect to the corporation actually making or withdrawing the investment).

(3) Special rule.— For purposes of this subpart, a United States shareholder of a controlled foreign corporation may, under regulations prescribed by the Secretary, elect to make the determinations under subsection (a)(2) of this section and under subsection (g) of section 954 as of the close of the years following the years referred to in such subsections, or as of the close of such longer period of time as such regulations may permit, in lieu of on the last day of such years. Any election under this paragraph made with respect to any taxable year shall apply to such year and to all succeeding taxable years unless the Secretary consents to the revocation of such election.

(4) Amount attributable to property.— The amount taken into account under this subpart with respect to any property described in paragraph (1) shall be its adjusted basis, reduced by any liability to which such property is subject.

(5) Income excluded under prior law.— Amounts invested in less developed country corporations described in section 955(c)(2) (as in effect before the enactment of the Tax Reduction Act of 1975) shall be treated as qualified investments in foreign base company shipping operations and shall not be treated as investments in less developed countries for purposes of section 951(a)(1)(A)(ii).

Section 956.
Investment of Earnings in United States Property

(a) General rule.— In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of—

(1) the excess (if any) of—

(A) such shareholder’s pro rata share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close of each quarter of such taxable year, over
(B) the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder, or

(2) such shareholder’s pro rata share of the applicable earnings of such controlled foreign corporation.

The amount taken into account under paragraph (1) with respect to any property shall be its adjusted basis as determined for purposes of computing earnings and profits, reduced by any liability to which the property is subject.

(b) Special Rules.—

(1) Applicable earnings.— For purposes of this section, the term “applicable earnings” means, with respect to any controlled foreign corporation, the sum of—

(A) the amount (not including a deficit) referred to in section 316(A)(1) to the extent such amount was accumulated in prior taxable years, and
(B) the amount referred to in section 316(a)(2), but reduced by distributions made during the taxable year and by earnings and profits described in section 959(c)(i).

(2) Special rule for U.S. property acquired before corporation is a controlled foreign corporation.— In applying subsection (a) to any taxable year, there shall be disregarded any item of United States property which was acquired by the controlled foreign corporation before the first day on which such corporation was treated as a controlled foreign corporation. The aggregate amount of property disregarded under the preceding sentence shall not exceed the portion of the applicable earnings of such controlled foreign corporation which were accumulated during periods before such first day.

(3) Special rule where corporation ceases to be controlled foreign corporation.— If any foreign corporation ceases to be a controlled foreign corporation during any taxable year—

(A) the determination of any United States shareholder’s pro rata share shall be made on the basis of stock owned (within the meaning of section 958(a))
by such shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation,

(B) the average referred to in subsection (a)(1)(A) for such taxable year shall be determined by only taking into account quarters ending on or before such last day, and

(C) in determining applicable earnings, the amount taken into account by reason of being described in paragraph (2) of section 316(a) shall be the portion of the amount so described which is allocable (on a pro rata basis) to the part of such year during which the corporation is a controlled foreign corporation.

(c) United States Property Defined.–

(1) In general.—For purposes of subsection (a), the term “United States property” means any property acquired after December 31, 1962, which is—

(A) tangible property located in the United States;
(B) stock of a domestic corporation;
(C) an obligation of a United States person; or
(D) any right to the use in the United States of—
   (i) a patent or copyright,
   (ii) an invention, model, or design (whether or not patented),
   (iii) a secret formula or process, or
   (iv) any other similar right,
which is acquired or developed by the controlled foreign corporation for use in the United States.

(2) Exceptions.—For purposes of subsection (a), the term “United States property” does not include—

(A) obligations of the United States, money, or deposits with—
   (i) any bank (as defined by section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)), without regard to subparagraphs (C) and (G) of paragraph (2) of such section), or
   (ii) any corporation not described in clause (i) with respect to which a bank holding company (as defined by section 2(a) of such Act) or financial holding company (as defined by section 2(p) of such Act) owns directly or indirectly more than 80 percent by vote or value of the stock of such corporation;
(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;
(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons;
(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;
(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business attributable to contracts which are not contracts described in section 953(a)(1);
(F) the stock or obligations of a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, nor a domestic corporation, 25 percent or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the controlled foreign corporation, is owned, or is considered as being owned, by such United States shareholders in the aggregate;
(G) any movable property (other than a vessel or aircraft) which is used for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or under such waters when used on the Continental Shelf of the United States;
(H) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b);
(I) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person’s business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin;
(J) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities;
(K) securities acquired and held by a controlled foreign corporation in the ordinary course of its business as a dealer in securities if—

(i) the dealer accounts for the securities as securities held primarily for sale to customers in the ordinary course of business, and

(ii) the dealer disposes of the securities (or such securities mature while held by the dealer) within a period consistent with the holding of securities for sale to customers in the ordinary course of business; and

(L) an obligation of a United States person which—

(i) is not a domestic corporation, and

(ii) is not—

(I) a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, or

(II) a partnership, estate, or trust in which the controlled foreign corporation, or any related person (as defined in section 954(d)(3)), is a partner, beneficiary, or trustee immediately after the acquisition of any obligation of such partnership, estate, or trust by the controlled foreign corporation.

For purposes of subparagraphs (I), (J), and (K), the term “dealer in securities” has the meaning given such term by section 475(c)(1), and the term “dealer in commodities” has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.

(c) Certain trade or service receivables acquired from related United States persons.—

(A) In general.—Notwithstanding paragraph (2) (other than subparagraph (H) thereof), the term “United States property” includes any trade or service receivable if—

(i) such trade or service receivable is acquired (directly or indirectly) from a related person who is a United States person, and

(ii) the obligor under such receivable is a United States person.

(B) Definitions.—For purposes of this paragraph, the term “trade or service receivable” and “related person” have the respective meanings given to such terms by section 864(d).

(d) Pledges and Guarantees.—For purposes of subsection (a), a controlled foreign corporation shall, under regulations prescribed by the Secretary, be considered as holding an obligation of a United States person if such controlled foreign corporation is a pledgor or guarantor of such obligations.

(e) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to prevent the avoidance of the provisions of this section through reorganizations or otherwise.

Section 957.
Controlled Foreign Corporations; United States Persons

(a) General rule.—For purposes of this subpart, the term “controlled foreign corporation” means any foreign corporation if more than 50 percent of—

(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(2) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

(b) Special Rule for Insurance.—For purposes only of taking into account income described in section 953(a) (relating to insurance income), the term “controlled foreign corporation” includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock (or more than 25 percent of the total value of stock) is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of the reinsurance or the issuing of insurance or annuity contracts described in section 953(a)(1) exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

(c) United States Person.—For purposes of this subpart, the term “United States person” has the meaning assigned to it by section 7701(a)(30) except that—

(1) with respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico, and

(2) with respect to a corporation organized under the laws of Guam, American Samoa, or the Northern Mariana Islands—
(A) 80 percent or more of the gross income of which for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within such a possession or was effectively connected with the conduct of a trade or business in such a possession, and

(B) 50 percent or more of the gross income of which for such period (or part) was derived from the active conduct of a trade or business within such a possession, such term does not include an individual who is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands.

For purposes of subparagraphs (A) and (B) of paragraph (2), the determination as to whether income was derived from the active conduct of a trade or business within a possession shall be made under regulations prescribed by the Secretary.

Section 958.

Rules for Determining Stock Ownership

(a) Direct and indirect ownership.—

(1) General rule.—For purposes of this subpart (other than sections 955(b)(1)(A) and (B), 955(c)(2)(A)(ii), and 960(a)(1)), stock owned means—

(A) stock owned directly, and

(B) stock owned with the application of paragraph (2).

(2) Stock ownership through foreign entities.—For purposes of subparagraph (B) of paragraph (1), stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, or foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered 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.

(3) Special rule for mutual insurance companies.—For purposes of applying paragraph (1) in the case of a foreign mutual insurance company, the term “stock” shall include any certificate entitling the holder to voting power in the corporation.

(b) Constructive Ownership.—For purposes of sections 951(b), 954(d)(3), 956(c)(2), and 957, section 318(a) (relating to constructive ownership of stock) shall apply to the extent that the effect is to treat any United States person as a United States shareholder of the controlled foreign corporation for purposes of section 956(c)(2), or to treat a foreign corporation as a controlled foreign corporation under section 957, except that—

(1) In applying paragraph (1)(A) of section 318(a), stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered as owned by a citizen or by a resident alien individual.

(2) In applying subparagraphs (A), (B), and (C) of section 318(a)(2), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of a corporation, it shall be considered as owning all the stock entitled to vote.

(3) In applying subparagraph (C) of section 318(a)(2), the phrase “10 percent” shall be substituted for the phrase “50 percent” used in subparagraph (C).

(4) Subparagraph (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.

Paragraphs (1) and (4) shall not apply for purposes of section 956(c)(2) to treat stock of a domestic corporation as not owned by a United States shareholder.

Section 959.

Exclusion from Gross Income of Previously Taxed Earnings and Profits

(a) Exclusion from gross income of United States persons.—For purposes of this chapter, the earnings and profits of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when—

(1) such amounts are distributed to, or

(2) such amounts would, but for this subsection, be included under section 951(a)(1)(B) in the gross income of, such shareholder (or any other United States person who acquires from any person any portion of the interest of such United States shareholder in such foreign corporation, but only to the extent of such portion, and subject to such proof of the identity of such interest as the Secretary may by regulations prescribe) directly or indirectly through a chain of ownership described under section 958(a), be again included in the gross income of such United States shareholder (or of such other United States person). The rules of subsection (c) shall apply for purposes of paragraph (1) of this subsection and the rules of subsection (f) shall apply for purposes of paragraph (2) of this subsection.
(b) Exclusion from Gross Income of Certain Foreign Subsidiaries.—For purposes of section 951(a), the earnings and profits of a controlled foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a), shall not, when distributed through a chain of ownership described under section 958(a), be also included in the gross income of another controlled foreign corporation in such chain for purposes of the application of section 951(a) to such other controlled foreign corporation with respect to such United States shareholder (or to any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder in the controlled foreign corporation, but only to the extent of such portion, and subject to such proof of identity of such interest as the Secretary may prescribe by regulations).

(c) Allocation of Distributions.—For purposes of subsections (a) and (b), section 316(a) shall be applied by applying paragraph (2) thereof, and then paragraph (1) thereof—

(1) first to the aggregate of—

(A) earnings and profits attributable to amounts included in gross income under section 951(a)(1)(B) (or which would have been included except for subsection (a)(2) of this section), and

(B) earnings and profits attributable to amounts included in gross income under section 951(a)(1)(C) (or which would have been included except for subsection (a)(3) of this section),

with any distribution being allocated between earnings and profits described in subparagraph (A) and earnings and profits described in subparagraph (B) proportionately on the basis of the respective amounts of such earnings and profits,

(2) then to earnings and profits attributable to amounts included in gross income under section 951(a)(1)(A) (but reduced by amounts not included under subparagraph (B) or (C) of section 951(a)(1) because of the exclusions in paragraphs (2) and (3) of subsection (a) of this section), and

(3) then to other earnings and profits.

References in this subsection to section 951(a)(1)(C) and subsection (a)(3) shall be treated as references to such provisions as in effect on the day before the date of the enactment of the Small Business Job Protection Act of 1996.

(d) Distributions Excluded From Gross Income Not To Be Treated as Dividends.—Except as provided in section 960(a)(3), any distribution excluded from gross income under subsection (a) shall be treated, for purposes of this chapter, as a distribution which is not a dividend; except that such distributions shall immediately reduce earnings and profits.

(e) Coordination with Amounts Previously Taxed Under Section 1248.—For purposes of this section and section 960(b), any amount included in the gross income of any person as a dividend by reason of subsection (a) or (f) of section 1248 shall be treated as an amount included in the gross income of such person (or, in any case to which section 1248(e) applies, of the domestic corporation referred to in section 1248(e)(2)) under section 951(a)(1)(A).

(f) Allocation Rules for Certain Inclusions.—

(1) In general.—For purposes of this section, amounts that would be included under subparagraph (B) of section 951(a)(1) (determined without regard to this section) shall be treated as attributable first to earnings described in subsection (c)(2), and then to earnings described in subsection (c)(3).

(2) Treatment of distributions.—In applying this section, actual distributions shall be taken into account before amounts that would be included under section 951(a)(1)(B) (determined without regard to this section).

Section 960.
Special Rules for Foreign Tax Credit

(a) Taxes Paid by a Foreign Corporation.—

(1) Deemed paid credit.—For purposes of subpart A of this part, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).

(A) of a foreign corporation (hereinafter in this subsection referred to as the “first foreign corporation”) at least 10 percent of the voting stock of which is owned by such domestic corporation, or

(B) of a second foreign corporation (hereinafter in this subsection referred to as the “second foreign corporation”) at least 10 percent of the voting stock of which is owned by the first foreign corporation, or

(C) of a third foreign corporation (hereinafter in this subsection referred to as the “third foreign corporation”) at least 10 percent of the voting stock of which is owned by the second foreign corporation, then, except to the extent provided in regulations, such domestic corporation shall be deemed to have paid a portion of such foreign corporation’s post-1986 foreign income taxes
determined under section 902 in the same manner as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)). This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.

(2) Taxes previously deemed paid by domestic corporation.— If a domestic corporation receives a distribution from a foreign corporation, any portion of which is excluded from gross income under section 959, the income, war profits, and excess profits taxes paid or deemed paid by such foreign corporation to any foreign country or to any possession of the United States in connection with the earnings and profits of such foreign corporation from which such distribution is made shall not be taken into account for purposes of section 902, to the extent such taxes were deemed paid by a domestic corporation under paragraph (1) for any prior taxable year.

(3) Taxes paid by foreign corporation and not previously deemed paid by domestic corporation.— Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

(b) Special Rules for Foreign Tax Credit in Year of Receipt of Previously Taxed Earnings and Profits.—

(1) Increase in section 904 limitation.— In the case of any taxpayer who—

(A) either (i) chose to have the benefits of subpart A of this part for a taxable year beginning after September 30, 1993, in which he was required under section 951(a) to include any amount in his gross income, or (ii) did not pay or accrue for such taxable year any income, war profits, or excess profits taxes to any foreign country or to any possession of the United States,

(B) chooses to have the benefits of subpart A of this part for any taxable year in which he receives 1 or more distributions or amounts which are excludable from gross income under section 959(a) and which are attributable to amounts included in his gross income for taxable years referred to in subparagraph (A), and

(C) for the taxable year in which such distributions or amounts are received, pays, or is deemed to have paid, or accrues income, war profits, or excess profits taxes to a foreign country or to any possession of the United States with respect to such distributions or amounts, the limitation under section 904 for the taxable year in which such distributions or amounts are received shall be increased by the lesser of the amount of such taxes paid, or deemed paid, or accrued with respect to such distributions or amounts or the amount in the excess limitation account as of the beginning of such taxable year.

(2) Excess limitation account.—

(A) Establishment of account.— Each taxpayer meeting the requirements of paragraph (1)(A) shall establish an excess limitation account. The opening balance of such account shall be zero.

(B) Increases in account.— For each taxable year beginning after September 30, 1993, the taxpayer shall increase the amount in the excess limitation account by the excess (if any) of—

(i) the amount by which the limitation under section 904(a) for such taxable year was increased by reason of the total amount of the inclusions in gross income under section 951(a) for such taxable year, over

(ii) the amount of any income, war profits, and excess profits taxes paid, or deemed paid, or accrued to any foreign country or possession of the United States which were allowable as a credit under section 901 for such taxable year and which would not have been allowable but for the inclusions in gross income described in clause (i).

Proper reductions in the amount added to the account under the preceding sentence for any taxable year shall be made for any increase in the credit allowable under section 901 for such taxable year by reason of a carryback if such increase would not have been allowable but for the inclusions in gross income described in clause (i).

(C) Decreases in account.— For each taxable year beginning after September 30, 1993, for which the limitation under section 904 was increased under paragraph (1), the taxpayer shall reduce the amount in the excess limitation account by the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)). This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.

Increases in account.— For each taxable year beginning after September 30, 1993, the taxpayer shall increase the amount in the excess limitation account by the excess (if any) of—

(i) the amount by which the limitation under section 904(a) for such taxable year was increased by reason of the total amount of the inclusions in gross income under section 951(a) for such taxable year, over

(ii) the amount of any income, war profits, and excess profits taxes paid, or deemed paid, or accrued to any foreign country or possession of the United States which were allowable as a credit under section 901 for such taxable year and which would not have been allowable but for the inclusions in gross income described in clause (i).

Proper reductions in the amount added to the account under the preceding sentence for any taxable year shall be made for any increase in the credit allowable under section 901 for such taxable year by reason of a carryback if such increase would not have been allowable but for the inclusions in gross income described in clause (i).

Distributions in account.— For each taxable year beginning before October 1, 1993, the taxpayer shall reduce the amount in the excess limitation account by the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)). This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.

Proper reductions in the amount added to the account under the preceding sentence for any taxable year shall be made for any increase in the credit allowable under section 901 for such taxable year by reason of a carryback if such increase would not have been allowable but for the inclusions in gross income described in clause (i).

Proper reductions in the amount added to the account under the preceding sentence for any taxable year shall be made for any increase in the credit allowable under section 901 for such taxable year by reason of a carryback if such increase would not have been allowable but for the inclusions in gross income described in clause (i).
under section 904 for the taxable year in which such amount or distribution is received shall be increased by the amount determined under this subsection as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1993.

(4) Cases in which taxes not to be allowed as deduction.—In the case of any taxpayer who—

(A) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951(a) to include in his gross income an amount in respect of a controlled foreign corporation, and

(B) does not choose to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 959(a) and which is attributable to earnings and profits of the controlled foreign corporation which was included in his gross income for the taxable year referred to in subparagraph (A),

no deduction shall be allowed under section 164 for the taxable year in which such distribution or amount is received for any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States on or with respect to such distribution or amount.

(5) Insufficient taxable income.—If an increase in the limitation under this subsection exceeds the tax imposed by this chapter for such year, the amount of such excess shall be deemed an overpayment of tax for such year.

Section 961.
Adjustments to Basis of Stock in Controlled Foreign Corporations and of Other Property

(a) Increase in basis.—Under regulations prescribed by the Secretary, the basis of a United States shareholder’s stock in a controlled foreign corporation, and the basis of property of a United States shareholder by reason of which he is considered under section 958(a)(2) as owning stock of a controlled foreign corporation, shall be increased by the amount required to be included in his gross income under section 951(a) with respect to such stock or with respect to such property, as the case may be, but only to the extent to which such amount was included in the gross income of such United States shareholder. In the case of a United States shareholder who has made an election under section 962 for the taxable year, the increase in basis provided by this subsection shall not exceed an amount equal to the amount of tax paid under this chapter with respect to the amounts required to be included in his gross income under section 951(a).

(b) Reduction in Basis.—

Section 962.
Election by Individuals to be Subject to Tax at Corporate Rates

(a) General rule.—Under regulations prescribed by the Secretary, in the case of a United States shareholder who is an individual and who elects to have the provisions of this section apply for the taxable year—

(1) the tax imposed under this chapter on amounts which are included in his gross income under section 951(a) shall (in lieu of the tax determined under sections 1 and 55) be an
The payments referred to in the preceding sentence are
decrease such earnings and profits or to increase such deficit.

(a) Earnings and profits.— Except as provided in section
312(k)(4), for purposes of this subpart, the earnings and profits
of any foreign corporation, and the deficit in earnings and profits
of any foreign corporation, for any taxable year shall be
determined according to rules substantially similar to those
applicable to domestic corporations, under regulations
prescribed by the Secretary. In determining such earnings and profits,
or the deficit in such earnings and profits, the amount of
any illegal bribe, kickback, or other payment (within the
meaning of section 162(c)) shall not be taken into account to
decrease such earnings and profits or to increase such deficit.
The payments referred to in the preceding sentence are
payments which would be unlawful under the Foreign Corrupt
Practices Act of 1977 if the payor were a United States person.

(b) Blocked foreign income.— Under regulations prescribed by the Secretary, no part of the earnings and profits
of a controlled foreign corporation for any taxable year shall be
included in earnings and profits for purposes of sections 952,
955, and 956, if it is established to the satisfaction of the
Secretary that such part could not have been distributed by the
controlled foreign corporation to United States shareholders
who own (within the meaning of section 958(a)) stock of such
controlled foreign corporation because of currency or other
restrictions or limitations imposed under the laws of any foreign
country.

(c) Pro ration of each section 11 bracket amount.— For
purposes of applying subsection (a)(1), the amount in each
taxable income bracket in the tax table in section 11(b) shall not
exceed an amount which bears the same ratio to such bracket
amount as the amount included in the gross income of the
United States shareholder under section 951(a) for the taxable
year bears to such shareholder’s pro rata share of the earnings
and profits for the taxable year of all controlled foreign
corporations with respect to which such shareholder includes any
amount in gross income under section 951(a).

(d) Special rule for actual distributions.— The earnings
and profits of a foreign corporation attributable to amounts
which were included in the gross income of a United States
shareholder under section 951(a) and with respect to which an
election under this section applied shall, when such earnings
and profits are distributed, notwithstanding the provisions of
section 959(a)(1), be included in gross income to the extent that
such earnings and profits so distributed exceed the amount of tax
paid under this chapter on the amounts to which such election
applied.

Section 964.
Miscellaneous Provisions

(a) Earnings and profits.— Except as provided in section
312(k)(4), for purposes of this subpart, the earnings and profits
of any foreign corporation, and the deficit in earnings and profits
of any foreign corporation, for any taxable year shall be
determined according to rules substantially similar to those
applicable to domestic corporations, under regulations
prescribed by the Secretary. In determining such earnings and profits,
or the deficit in such earnings and profits, the amount of
any illegal bribe, kickback, or other payment (within the
meaning of section 162(c)) shall not be taken into account to
decrease such earnings and profits or to increase such deficit.
The payments referred to in the preceding sentence are
payments which would be unlawful under the Foreign Corrupt
Practices Act of 1977 if the payor were a United States person.

(b) Blocked foreign income.— Under regulations prescribed by the Secretary, no part of the earnings and profits
of a controlled foreign corporation for any taxable year shall be
included in earnings and profits for purposes of sections 952,
955, and 956, if it is established to the satisfaction of the
Secretary that such part could not have been distributed by the
controlled foreign corporation to United States shareholders
who own (within the meaning of section 958(a)) stock of such
controlled foreign corporation because of currency or other
restrictions or limitations imposed under the laws of any foreign
country.

(c) Records and accounts of United States shareholders.—

(1) Records and accounts to be maintained.— The
Secretary may by regulations require each person who is, or
has been, a United States shareholder of a controlled foreign
corporation to maintain such records and accounts as may be
prescribed by such regulations as necessary to carry out the
provisions of this subpart and subpart G.

(2) Two or more persons required to maintain or
furnish the same records and accounts with respect to
the same foreign corporation.— Where, but for this
paragraph, two or more United States persons would be
required to maintain or furnish the same records and
accounts as may be required under paragraph (1) with respect to
the same controlled foreign corporation for the same period, the Secretary may by regulations provide
that the maintenance or furnishing of such records and
accounts by only one such person shall satisfy the
requirements of paragraph (1) for such other persons.

(d) Treatment of certain branches.—

(1) In general.— For purposes of this chapter, section
6038, section 6046, and such other provisions as may be
specified in regulations—

(A) a qualified insurance branch of a controlled foreign
corporation shall be treated as a separate foreign corpora-
tion created under the laws of the foreign country with
respect to which such branch qualifies under paragraph
(2), and

(B) except as provided in regulations, any amount
directly or indirectly transferred or credited from such
branch to one or more other accounts of such controlled
foreign corporation shall be treated as a dividend paid to
such controlled foreign corporation.

(2) Qualified insurance branch.— For purposes of
paragraph (1), the term “qualified insurance branch” means
any branch of a controlled foreign corporation which is licensed and predominantly engaged on a permanent basis in the active conduct of an insurance business in a foreign country if—

(A) separate books and accounts are maintained for such branch,

(B) the principal place of business of such branch is in such foreign country,

(C) such branch would be taxable under subchapter L if it were a separate domestic corporation, and

(D) an election under this paragraph applies to such branch.

An election under this paragraph shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(3) Regulations.— The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

e) Gain on Certain Stock Sales by Controlled Foreign Corporations Treated as Dividends.—

(1) In general.— If a controlled foreign corporation sells or exchanges stock in any other foreign corporation, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend to the same extent that it would have been so included under section 1248(a) if such controlled foreign corporation were a United States person. For purposes of determining the amount which would have been so includible, the determination of whether such other foreign corporation was a controlled foreign corporation shall be made without regard to the preceding sentence.

(2) Same country exception not applicable.— Clause (i) of section 954(c)(3)(A) shall not apply to any amount treated as a dividend by reason of paragraph (1).

(3) Clarification of deemed sales.— For purposes of this subsection, a controlled foreign corporation shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such controlled foreign corporation is treated as having gain from the sale or exchange of such stock.

Section 965.
Temporary Dividends Received Deduction

(a) Deduction.—

(1) In general.— In the case of a corporation which is a United States shareholder and for which the election under this section is in effect for the taxable year, there shall be allowed as a deduction an amount equal to 85 percent of the cash dividends which are received during such taxable year by such shareholder from controlled foreign corporations.

(2) Dividends paid indirectly from controlled foreign corporations.— If, within the taxable year for which the election under this section is in effect, a United States shareholder receives a cash distribution from a controlled foreign corporation which is excluded from gross income under section 959(a), such distribution shall be treated for purposes of this section as a cash dividend to the extent of any amount included in income by such United States shareholder under section 951(a)(1)(A) as a result of any cash dividend during such taxable year to—

(A) such controlled foreign corporation from another controlled foreign corporation that is in a chain of ownership described in section 958(a), or

(B) any other controlled foreign corporation in such chain of ownership from another controlled foreign corporation in such chain of ownership, but only to the extent of cash distributions described in section 959(b) which are made during such taxable year to the controlled foreign corporation from which such United States shareholder received such distribution.

(b) Limitations.—

(1) In general.— The amount of dividends taken into account under subsection (a) shall not exceed the greater of—

(A) $500,000,000,

(B) the amount shown on the applicable financial statement as earnings permanently reinvested outside the United States, or

(C) in the case of an applicable financial statement which fails to show a specific amount of earnings permanently reinvested outside the United States and which shows a specific amount of tax liability attributable to such earnings, the amount equal to the amount of such liability divided by 0.35.

The amounts described in subparagraphs (B) and (C) shall be treated as being zero if there is no such statement or such statement fails to show a specific amount of such earnings or liability, as the case may be.

(2) Dividends must be extraordinary.— The amount of dividends taken into account under subsection (a) shall not exceed the excess (if any) of—

(A) the cash dividends received during the taxable year by such shareholder from controlled foreign corporations, over

(B) the annual average for the base period years of—

(i) the dividends received during each base period year by such shareholder from controlled foreign corporations,
(ii) the amounts includible in such shareholder’s gross income for each base period year under section 951(a)(1)(B) with respect to controlled foreign corporations, and

(iii) the amounts that would have been included for each base period year but for section 959(a) with respect to controlled foreign corporations.

The amount taken into account under clause (iii) for any base period year shall not include any amount which is not includible in gross income by reason of an amount described in clause (ii) with respect to a prior taxable year. Amounts described in subparagraph (B) for any base period year shall be such amounts as shown on the most recent return filed for such year; except that amended returns filed after June 30, 2003, shall not be taken into account.

(3) Reduction of benefit if increase in related party indebtedness.– The amount of dividends which would (but for this paragraph) be taken into account under subsection (a) shall be reduced by the excess (if any) of—

(A) the amount of indebtedness of the controlled foreign corporation to any related person (as defined in section 954(d)(3)) as of the close of the taxable year for which the election under this section is in effect, over

(B) the amount of indebtedness of the controlled foreign corporation to any related person (as so defined) as of the close of October 3, 2004.

All controlled foreign corporations with respect to which the taxpayer is a United States shareholder shall be treated as 1 controlled foreign corporation for purposes of this paragraph. The Secretary may prescribe such regulations as may be necessary or appropriate to prevent the avoidance of the purposes of this paragraph.

(c) Definitions and special rules.– For purposes of this section—

(1) Applicable financial statement.– The term “applicable financial statement” means—

(A) with respect to a United States shareholder which is required to file a financial statement with the Securities and Exchange Commission (or which is included in such a statement so filed by another person), the most recent audited annual financial statement (including the notes which form an integral part of such statement) of such shareholder (or which includes such shareholder)—

(i) which was so filed on or before June 30, 2003, and

(ii) which was certified on or before June 30, 2003, as being prepared in accordance with generally accepted accounting principles, and

(B) with respect to any other United States shareholder, the most recent audited financial statement (including the notes which form an integral part of such statement) of such shareholder (or which includes such shareholder)—

(i) which was certified on or before June 30, 2003, as being prepared in accordance with generally accepted accounting principles, and

(ii) which is used for the purposes of a statement or report—

(I) to creditors,

(II) to shareholders, or

(III) for any other substantial nontax purpose.

(2) Base period years.–

(A) In general.– The base period years are the 3 taxable years—

(i) which are among the 5 most recent taxable years ending on or before June 30, 2003, and

(ii) which are determined by disregarding—

(I) 1 taxable year for which the sum of the amounts described in clauses (i), (ii), and (iii) of subsection (b)(2)(B) is the largest, and

(II) 1 taxable year for which such sum is the smallest.

(B) Shorter period.– If the taxpayer has fewer than 5 taxable years ending on or before June 30, 2003, then in lieu of applying subparagraph (A), the base period years

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shall include all the taxable years of the taxpayer ending on or before June 30, 2003.

(C) **Mergers, acquisitions, etc.–**

(i) In general.– Rules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of this paragraph.

(ii) Spin-offs, etc.– If there is a distribution to which section 355 (or so much of section 356 as relates to section 355) applies during the 5-year period referred to in subparagraph (A)(i) and the controlled corporation (within the meaning of section 355) is a United States shareholder—

(I) the controlled corporation shall be treated as being in existence during the period that the distributing corporation (within the meaning of section 355) is in existence, and

(II) for purposes of applying subsection (b)(2) to the controlled corporation and the distributing corporation, amounts described in subsection (b)(2)(B) which are received or includible by the distributing corporation or controlled corporation (as the case may be) before the distribution referred to in subclause (I) from a controlled foreign corporation shall be allocated between such corporations in proportion to their respective interests as United States shareholders of such controlled foreign corporation immediately after such distribution.

Subclause (II) shall not apply if neither the controlled corporation nor the distributing corporation is a United States shareholder of such controlled foreign corporation immediately after such distribution.

(3) **Dividend.–** The term “dividend” shall not include amounts includible in gross income as a dividend under section 78, 367, or 1248. In the case of a liquidation under section 332 to which section 367(b) applies, the preceding sentence shall not apply to the extent the United States shareholder actually receives cash as part of the liquidation.

(4) **Coordination with dividend received deduction.–** No deduction shall be allowed under section 243 or 245 for any dividend for which a deduction is allowed under this section.

(5) **Controlled groups.–**

(A) In general.– All United States shareholders which are members of an affiliated group filing a consolidated return under section 1501 shall be treated as one United States shareholder.

(B) **Application of $500,000,000 limit.–** All corporations which are treated as a single employer under section 52(a) shall be limited to one $500,000,000 amount in subsection (b)(1)(A), and such amount shall be divided among such corporations under regulations prescribed by the Secretary.

(C) Permanently reinvested earnings.– If a financial statement is an applicable financial statement for more than 1 United States shareholder, the amount applicable under subparagraph (B) or (C) of subsection (b)(1) shall be divided among such shareholders under regulations prescribed by the Secretary.

(d) **Denial of foreign tax credit; denial of certain expenses.–**

(1) Foreign tax credit.– No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to the deductible portion of—

(A) any dividend, or

(B) any amount described in subsection (a)(2) which is included in income under section 951(a)(1)(A).

No deduction shall be allowed under this chapter for any tax for which credit is not allowable by reason of the preceding sentence.

(2) Expenses.– No deduction shall be allowed for expenses directly allocable to the deductible portion described in paragraph (1).

(3) **Deductible portion.–** For purposes of paragraph (1), unless the taxpayer otherwise specifies, the deductible portion of any dividend or other amount is the amount which bears the same ratio to the amount of such dividend or other amount as the amount allowed as a deduction under subsection (a) for the taxable year bears to the amount described in subsection (b)(2)(A) for such year.

(4) **Coordination with section 78.–** Section 78 shall not apply to any tax which is not allowable as a credit under section 901 by reason of this subsection.

(e) **Increase in tax on included amounts not reduced by credits, etc.–**

(1) In general.– Any tax under this chapter by reason of nondeductible CFC dividends shall not be treated as tax imposed by this chapter for purposes of determining—

(A) the amount of any credit allowable under this chapter, or

(B) the amount of the tax imposed by section 55.

Subparagraph (A) shall not apply to the credit under section 53 or to the credit under section 27(a) with respect to taxes which are imposed by foreign countries and possessions of the United States and are attributable to such dividends.

(2) **Limitation on reduction in taxable income, etc.–**

(A) In general.– The taxable income of any United States shareholder for any taxable year shall in no event be
less than the amount of nondeductible CFC dividends received during such year.

(B) Coordination with section 172.— The nondeductible CFC dividends for any taxable year shall not be taken into account—

(i) in determining under section 172 the amount of any net operating loss for such taxable year, and

(ii) in determining taxable income for such taxable year for purposes of the 2nd sentence of section 172(b)(2).

(3) Nondeductible CFC dividends.— For purposes of this subsection, the term “nondeductible CFC dividends” means the excess of the amount of dividends taken into account under subsection (a) over the deduction allowed under subsection (a) for such dividends.

(f) Election.— The taxpayer may elect to apply this section to—

(1) the taxpayer’s last taxable year which begins before the date of the enactment of this section, or

(2) the taxpayer’s first taxable year which begins during the 1-year period beginning on such date.

Such election may be made for a taxable year only if made on or before the due date (including extensions) for filing the return of tax for such taxable year.

Subpart I—Admissibility of Documentation Maintained in Foreign Countries

[§ 982]

Section 982.
Admissibility of Documentation Maintained in Foreign Countries

(a) General rule.— If the taxpayer fails to substantially comply with any formal document request arising out of the examination of the tax treatment of any item (hereinafter in this section referred to as the “examined item”) before the 90th day after the date of the mailing of such request on motion by the Secretary, any court having jurisdiction of a civil proceeding in which the tax treatment of the examined item is an issue shall prohibit the introduction by the taxpayer of any foreign-based documentation covered by such request.

(b) Reasonable Cause Exception.—

(1) In general.— Subsection (a) shall not apply with respect to any documentation if the taxpayer establishes that the failure to provide the documentation as requested by the Secretary is due to reasonable cause.

(2) Foreign nondisclosure law not reasonable cause.— For purposes of paragraph (1), the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the requested documentation is not reasonable cause.

(c) Formal Document Request.— For purposes of this section—

(1) Formal document request.— The term “formal document request” means any request (made after the normal request procedures have failed to produce the requested documentation) for the production of foreign-based documentation which is mailed by registered or certified mail to the taxpayer at his last known address and which sets forth—

(A) the time and place for the production of the documentation,

(B) a statement of the reason the documentation previously produced (if any) is not sufficient,

(C) a description of the documentation being sought, and

(D) the consequences to the taxpayer of the failure to produce the documentation described in subparagraph (C).

(2) Proceeding to quash.—

(A) In general.— Notwithstanding any other law or rule of law, any person to whom a formal document request is mailed shall have the right to begin a proceeding to quash such request not later than the 90th day after the day such request was mailed. In any such proceeding, the Secretary may seek to compel compliance with such request.

(B) Jurisdiction.— The United States district court for the district in which the person (to whom the formal document request is mailed) resides or is found shall have jurisdiction to hear any proceeding brought under subparagraph (A). An order denying the petition shall be deemed a final order which may be appealed.

(C) Suspension of 90-day period.— The running of the 90-day period referred to in subsection (a) shall be suspended during any period during which a proceeding brought under subparagraph (A) is pending.

(d) Definitions and Special Rules.— For purposes of this section—

(1) Foreign-based documentation.— The term “foreign-based documentation” means any documentation which is outside the United States and which may be relevant or material to the tax treatment of the examined item.
(2) Documentation.— The term “documentation” includes books and records.

(3) Authority to extend 90-day period.— The Secretary, and any court having jurisdiction over a proceeding under subsection (c)(2), may extend the 90-day period referred to in subsection (a).

(c) Suspension of Statute of Limitations.— If any person takes any action as provided in subsection (c)(2), the running of any period of limitations under section 6501 (relating to the assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period during which the proceeding under such subsection, and appeals therein, are pending.

Subpart J—Foreign Currency Transactions

Section 985.
Functional Currency

(a) In general.— Unless otherwise provided in regulations, all determinations under this subtitle shall be made in the taxpayer’s functional currency.

(b) Functional Currency.—

(1) In general.— For purposes of this subtitle, the term “functional currency” means—

(A) except as provided in subparagraph (B), the dollar, or

(B) in the case of a qualified business unit, the currency of the economic environment in which a significant part of such unit’s activities are conducted and which is used by such unit in keeping its books and records.

(2) Functional currency where activities primarily conducted in dollars.— The functional currency of any qualified business unit shall be the dollar if activities of such unit are primarily conducted in dollars.

(3) Election.— To the extent provided in regulations, the taxpayer may elect to use the dollar as the functional currency for any qualified business unit if—

(A) such unit keeps its books and records in dollars, or

(B) the taxpayer uses a method of accounting that approximates a separate transactions method.

Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(4) Change in functional currency treated as a change in method of accounting.— Any change in the functional currency shall be treated as a change in the taxpayer’s method of accounting for purposes of section 481 under procedures to be established by the Secretary.

Section 986.
Determination of Foreign Taxes and Foreign Corporation’s Earnings and Profits

(a) Foreign Income Taxes.—

(1) Translation of accrued taxes.—

(A) In general. For purposes of determining the amount of the foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued, the amount of any foreign income taxes (and any adjustment thereto) shall be translated into dollars by using the average exchange rate for the taxable year to which such taxes relate.

(B) Exception for certain taxes.— Subparagraph (A) shall not apply to any foreign income taxes—

(i) paid after the date 2 years after the close of the taxable year to which such taxes relate, or

(ii) paid before the beginning of the taxable year to which such taxes relate.

(C) Exception for inflationary currencies.— Subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any inflationary currency (as determined under regulations).

(D) Elective exception for taxes paid other than in functional currency.—

(i) In general.— At the election of the taxpayer, subparagraph (A) shall not apply to any foreign income taxes—

(A) kept in the books and records of the taxpayer in dollars, or

(B) paid or accrued with respect to any item of income or gain, loss, or deduction that is the amount of an item of income or gain, loss, or deduction in a foreign currency.

(ii) Application to qualified business units.— An election under this subparagraph may apply to foreign income taxes attributable to a qualified business unit in accordance with regulations prescribed by the Secretary.

(iii) Election.— Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(E) Special rule for regulated investment companies.— In the case of a regulated investment company which takes into account income on an accrual basis, subparagraphs (A) through (D) shall not apply and foreign income taxes paid or accrued with respect to such income shall be translated into dollars using the exchange rate as of the date the income accrues.
Section 987. Branch Transactions

In the case of any taxpayer having 1 or more qualified business units with a functional currency other than the dollar, taxable income of such taxpayer shall be determined—

(1) by computing the taxable income or loss separately for each such unit in its functional currency,

(2) by translating the income or loss separately computed under paragraph (1) at the appropriate exchange rate, and

(3) by making proper adjustments (as prescribed by the Secretary) for transfers of property between qualified business units of the taxpayer having different functional currencies, including—

(A) treating post-1986 remittances from each such unit as made on a pro rata basis out of post-1986 accumulated earnings, and

(B) treating gain or loss determined under this paragraph as ordinary income or loss, respectively, and sourcing such gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings.

Section 988. Treatment of Certain Foreign Currency Transactions

(a) General rule. – Notwithstanding any other provisions of this chapter—

(1) Treatment as ordinary income or loss. –

(A) In general. – Except as otherwise provided in this section, any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss (as the case may be).

(B) Special rule for forward contracts, etc. – Except as provided in regulations, a taxpayer may elect to treat any foreign currency gain or loss attributable to a forward contract, a futures contract, or option described in subsection (c)(1)(B)(iii) which is a capital asset in the hands of the taxpayer and which is not a part of a straddle (within the meaning of section 1092(c), without regard to paragraph (4) thereof) as capital gain or loss (as the case may be) if the taxpayer makes such election and identifies such transaction before the close of the day on which such transaction is entered into (or such earlier time as the Secretary may prescribe).

(2) Gain or loss treated as interest for certain purposes.— To the extent provided in regulations, any amount
treated as ordinary income or loss under paragraph (1) shall be treated as interest income or expense (as the case may be).

(3) Source.—

(A) In general.— Except as otherwise provided in regulations, in the case of any amount treated as ordinary income or loss under paragraph (1) (without regard to paragraph (1)(B)), the source of such amount shall be determined by reference to the residence of the taxpayer or the qualified business unit of the taxpayer on whose books the asset, liability, or item of income or expense is properly reflected.

(B) Residence.— For purposes of this subpart—

(i) In general.— The residence of any person shall be—

(I) in the case of an individual, the country in which such individual’s tax home (as defined in section 911(d)(3)) is located,

(II) in the case of any corporation, partnership, trust, or estate which is a United States person (as defined in section 7701(a)(30)), the United States, and

(III) in the case of any corporation, partnership, trust, or estate which is not a United States person, a country other than the United States.

If an individual does not have a tax home (as so defined), the residence of such individual shall be the United States if such individual is a United States citizen or a resident alien and shall be a country other than the United States if such individual is not a United States citizen or a resident alien.

(ii) Exception.— In the case of a qualified business unit of any taxpayer (including an individual), the residence of such unit shall be the country in which the principal place of business of such qualified business unit is located.

(C) Special rule for partnerships.— To the extent provided in regulations, in the case of a partnership, the determination of residence shall be made at the partner level.

(D) Special rule for certain related party loans.— Except to the extent provided in regulations, in the case of a loan by a United States person or a related person to a 10-percent owned foreign corporation which is denominated in a currency other than the dollar and bears interest at a rate at least 10 percentage points higher than the Federal mid-term rate (determined under section 1274(d)) at the time such loan is entered into, the following rules shall apply:

(i) For purposes of section 904 only, such loan shall be marked to market on an annual basis.

(ii) Any interest income earned with respect to such loan for the taxable year shall be treated as income from sources within the United States to the extent of any loss attributable to clause (i).

For purposes of this subparagraph, the term “related person” has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting “United States person” for “controlled foreign corporation” each place such term appears.

(D) 10-percent owned foreign corporation.— The term “10-percent owned foreign corporation” means any foreign corporation in which the United States person owns directly or indirectly at least 10 percent of the voting stock.

(b) Foreign Currency Gain or Loss.— For purposes of this section—

(1) Foreign currency gain.— The term “foreign currency gain” means any gain from a section 988 transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date.

(2) Foreign currency loss.— The term “foreign currency loss” means any loss from a section 988 transaction to the extent such loss does not exceed the loss realized by reason of changes in exchange rates on or after the booking date and before the payment date.

(3) Special rule for certain contracts, etc.— In the case of any section 988 transaction described in subsection (c)(1)(B)(iii), any gain or loss from such transaction shall be treated as foreign currency gain or loss (as the case may be).

(c) Other Definitions.— For purposes of this section—

(1) Section 988 transaction.—

(A) In general.— The term “section 988 transaction” means any transaction described in subparagraph (B) if the amount which the taxpayer is entitled to receive (or is required to pay) by reason of such transaction—

(i) is denominated in terms of a nonfunctional currency, or

(ii) is determined by reference to the value of 1 or more nonfunctional currencies.

(B) Description of transactions.— For purposes of subparagraph (A), the following transactions are described in this subparagraph:

(i) The acquisition of a debt instrument or becoming the obligor under a debt instrument.

(ii) Accruing (or otherwise taking into account) for purposes of this subtitle any item of expense or gross
income or receipts which is to be paid or received after the date on which so accrued or taken into account.

(iii) Entering into or acquiring any forward contract, futures contract, option, or similar financial instrument.

The Secretary may prescribe regulations excluding from the application of clause (ii) any class of items the taking into account of which is not necessary to carry out the purposes of this section by reason of the small amounts or short periods involved, or otherwise.

(C) Special rules for disposition of nonfunctional currency.—

(i) In general.— In the case of any disposition of any nonfunctional currency—

(I) such disposition shall be treated as a section 988 transaction, and

(II) any gain or loss from such transaction shall be treated as foreign currency gain or loss (as the case may be).

(ii) Nonfunctional currency.— For purposes of this section, the term “nonfunctional currency” includes coin or currency, and nonfunctional currency denominated demand or time deposits or similar instruments issued by a bank or other financial institution.

(D) Exception for certain instruments marked to market.—

(i) In general.— Clause (iii) of subparagraph (B) shall not apply to any regulated futures contract or nonequity option which would be marked to market under section 1256 if held on the last day of the taxable year.

(ii) Election out.—

(I) In general.— The taxpayer may elect to have clause (i) not apply to such taxpayer. Such an election shall apply to contracts held at any time during the taxable year for which such election is made or any succeeding taxable year unless such election is revoked with the consent of the Secretary.

(II) Time for making election.— Except as provided in regulations, an election under subclause (I) for any taxable year shall be made on or before the 1st day of such taxable year (or, if later, on or before the 1st day during such year on which the taxpayer holds a contract described in clause (i)).

(III) Special rule for partnerships, etc.— In the case of a partnership, an election under subclause (I) shall be made by each partner separately. A similar rule shall apply in the case of an S corporation.

(iii) Treatment of certain partnerships.— This subparagraph shall not apply to any income or loss of a partnership for any taxable year if such partnership made an election under subparagraph (E)(iii)(V) for such year or any preceding year.

(E) Special rules for certain funds.—

(i) In general.— In the case of a qualified fund, clause (iii) of subparagraph (B) shall not apply to any instrument which would be marked to market under section 1256 if held on the last day of the taxable year (determined after the application of clause (iv)).

(ii) Special rule where electing partnership does not qualify.— If any partnership made an election under clause (iii)(V) for any taxable year and such partnership has a net loss for such year or any succeeding year from instruments referred to in clause (i), the rules of clauses (i) and (iv) shall apply to any such loss year whether or not such partnership is a qualified fund for such year.

(iii) Qualified fund defined.— For purposes of this subparagraph, the term “qualified fund” means any partnership if—

(I) at all times during the taxable year (and during each preceding taxable year to which an election under subclause (V) applied), such partnership has at least 20 partners and no single partner owns more than 20 percent of the interests in the capital or profits of the partnership,

(II) the principal activity of such partnership for such taxable year (and each such preceding taxable year) consists of buying and selling options, futures, or forwards with respect to commodities,

(III) at least 90 percent of the gross income of the partnership for the taxable year (and for each such preceding taxable year) consisted of income or gains described in subparagraph (A), (B), or (G) of section 7704(d)(1) or gain from the sale or disposition of capital assets held for the production of interest or dividends,

(IV) no more than a de minimis amount of the gross income of the partnership for the taxable year (and each such preceding taxable year) was derived from buying and selling commodities, and

(V) an election under this subclause applies to the taxable year.

An election under subclause (V) for any taxable year shall be made on or before the 1st day of such taxable year (or, if later, on or before the 1st day during such year on which the partnership holds an instrument referred to in clause (i)). Any such election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.
(iv) Treatment of certain currency contracts.—
   (I) In general.— Except as provided in regulations, in the case of a qualified fund, any bank
   forward contract, any foreign currency futures contract traded on a foreign exchange, or to the
   extent provided in regulations any similar instrument, which is not otherwise a section 1256 contract
   shall be treated as a section 1256 contract for purposes of section 1256.

   (II) Gains and losses treated as short-term.— In the case of any instrument treated as a section
   1256 contract under subclause (I), subparagraph (A) of section 1256(a)(3) shall be applied by substituting
   “100 percent” for “40 percent” (and subparagraph (B) of such section shall not apply).

   (v) Special rules for clause (iii)(I).—
      (1) Certain general partners.— The interest of a general partner in the partnership shall not be
      treated as failing to meet the 20-percent ownership requirements of clause (iii)(I) for any taxable year of
      the partnership if, for the taxable year of the partner in which such partnership taxable year ends, such
      partner (and each corporation filing a consolidated return with such partner) had no ordinary income or
      loss from a section 988 transaction which is foreign currency gain or loss (as the case may be).

      (II) Treatment of incentive compensation.— For purposes of clause (iii)(I), any income allocable
      to a general partner as incentive compensation based on profits rather than capital shall not be taken into
      account in determining such partner’s interest in the profits of the partnership.

      (III) Treatment of tax-exempt partners.— Except as provided in regulations, the interest of a partner
      in the partnership shall not be treated as failing to meet the 20-percent ownership requirements of clause
      (iii)(I) if none of the income of such partner from such partnership is subject to tax under this chapter (whether directly or through 1 or more pass-thru entities).

      (IV) Look-thru rule.— In determining whether the requirements of clause (iii)(I) are met with
      respect to any partnership, except to the extent provided in regulations, any interest in such
      partnership held by another partnership shall be treated as held proportionately by the partners in
      such other partnership.

      (vi) Other special rules.— For purposes of this subparagraph—
         (I) Related persons.— Interests in the partnership held by persons related to each other
         (within the meaning of sections 267(b) and 707(b)) shall be treated as held by 1 person.

      (II) Predecessors.— References to any partnership shall include a reference to any
      predecessor thereof.

      (III) Inadvertent terminations.— Rules similar to the rules of section 7704(e) shall apply.

      (IV) Treatment of certain debt instruments.— For purposes of clause (iii)(IV), any debt instrument
         which is a section 988 transaction shall be treated as a commodity.

(2) Booking date.— The term “booking date” means—
      (A) in the case of a transaction described in paragraph (1)(B)(i), the date of acquisition or on which the taxpayer
      becomes the obligor, or

      (B) in the case of a transaction described in paragraph (1)(B)(ii), the date on which accrued or otherwise taken
      into account.

(3) Payment date.— The term “payment date” means the
date on which the payment is made or received.

(4) Debt instrument.— The term “debt instrument”
means a bond, debenture, note, or certificate or other evidence of indebtedness. To the extent provided in regulations, such term shall include preferred stock.

(5) Special rules where taxpayer takes or makes delivery.— If the taxpayer takes or makes delivery in connection with any section 988 transaction described in paragraph (1)(B)(iii), any gain or loss (determined as if the taxpayer sold the contract, option, or instrument on the date on which he took or made delivery for its fair market value on such date) shall be recognized in the same manner as if such contract, option, or instrument were so sold.

(d) Treatment of 988 Hedging Transactions.—
   (1) In general.— To the extent provided in regulations, if any section 988 transaction is part of a 988 hedging transaction, all transactions which are part of such 988 hedging transaction shall be integrated and treated as a single transaction or otherwise treated consistently for purposes of this subtitle. For purposes of the preceding sentence, the determination of whether any transaction is a section 988 transaction shall be determined without regard to whether such transaction would otherwise be marked-to-market under section 475 or 1256 and such term shall not include any transaction with respect to which an election is made under subsection (a)(1)(B). Sections 492, 1092 and 1256 shall not apply to a transaction covered by this subsection.

   (2) 988 hedging transaction.— For purposes of paragraph (1), the term “988 hedging transaction” means any transaction—
(A) entered into by the taxpayer primarily—

(i) to manage risk of currency fluctuations with respect to property which is held or to be held by the taxpayer, or

(ii) to manage risk of currency fluctuations with respect to borrowings made or to be made, or obligations incurred or to be incurred, by the taxpayer, and

(B) identified by the Secretary or the taxpayer as being a 988 hedging transaction.

(e) Application to Individuals.—

(1) In general.—The preceding provisions of this section shall not apply to any section 988 transaction entered into by an individual which is a personal transaction.

(2) Exclusion for certain personal transactions.—

(A) nonfunctional currency is disposed of by an individual in any transaction, and

(B) such transaction is a personal transaction, no gain shall be recognized for purposes of this subtitle by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition. The preceding sentence shall not apply if the gain which would otherwise be recognized on the transaction exceeds $200.

(3) Personal transactions.—For purposes of this subsection, the term ‘personal transaction’ means any transaction entered into by an individual, except that such term shall not include any transaction to the extent that expenses properly allocable to such transaction meet the requirements of—

(A) section 162 (other than traveling expenses described in subsection (a)(2) thereof), or

(B) section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

Section 989.
Other Definitions and Special Rules

(a) Qualified business unit.—For purposes of this subpart, the term “qualified business unit” means any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records.

(b) Appropriate Exchange Rate.—Except as provided in regulations, for purposes of this subpart, the term “appropriate exchange rate” means—

(1) in the case of an actual distribution of earnings and profits, the spot rate on the date such distribution is included in income,

(2) in the case of an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the spot rate on the date the deemed dividend is included in income,

(3) in the case of any amounts included in income under section 951(a)(1)(A) or 1293(a), the average exchange rate for the taxable year of the foreign corporation, or

(4) in the case of any other qualified business unit of a taxpayer, the average exchange rate for the taxable year of such qualified business unit.

For purposes of the preceding sentence, any amount included in income under section 951(a)(1)(B) shall be treated as an actual distribution made on the last day of the taxable year for which such amount was so included.

(c) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart, including regulations—

(1) setting forth procedures to be followed by taxpayers with qualified business units using a net worth method of accounting before the enactment of this subpart,

(2) limiting the recognition of foreign currency loss on certain remittances from qualified business units,

(3) providing for the recharacterization of interest and principal payments with respect to obligations denominated in certain hyperinflationary currencies,

(4) providing for alternative adjustments to the application of section 905(c),

(5) providing for the appropriate treatment of related party transactions (including transactions between qualified business units of the same taxpayer), and

(6) setting forth procedures for determining the average exchange rate for any period.

Section 1031.
Exchange of Property Held for Productive Use or Investment

(a) Nonrecognition of Gain or Loss from Exchanges Solely in Kind.—

(1) In general.—No gain or loss shall be recognized on the exchange of property held for productive use in a trade or
business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

* * *

(h) Special Rules for Foreign Real and Personal Property.—For purposes of this section—

(1) Real property.—Real property located in the United States and real property located outside the United States are not property of a like kind.

(2) Personal property.—

(A) In general.—Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.

(B) Predominant use.—Except as provided in subparagraphs (C) and (D), the predominant use of any property shall be determined based on—

(i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and

(ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.

(C) Property held for less than 2 years.—Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection—

(i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i), and

(ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii).

(D) Special rule for certain property.—Property described in any subparagraph of section 168(g)(4) shall be treated as used predominantly in the United States.

* * *

Section 1059A.
Limitation on Taxpayer’s Basis or Inventory Cost in Property Imported from Related Persons

(a) In General.—If any property is imported into the United States in a transaction (directly or indirectly) between related persons (within the meaning of section 482), the amount of any costs—

(1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and

(2) which are also taken into account in computing the customs value of such property,
shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.

(b) Customs Value; Import.—For purposes of this section—

(1) Customs value.—The term “customs value” means the value taken into account for purposes of determining the amount of any customs duties or any other duties which may be imposed on the importation of any property.

(2) Import.—Except as provided in regulations, the term “import” means the entering, or withdrawal from warehouse, for consumption.

Subchapter P—Capital Gains and Losses
Parts I—V
[§§ 1246—1273]

Section 1248.
Gain from Certain Sales or Exchanges of Stock in Certain Foreign Corporations

(a) General Rule.—If—

(1) a United States person sells or exchanges stock in a foreign corporation, and

(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),
then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. For purposes of this section, a United States person shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such person is treated as realizing gain from the sale or exchange of such stock.
(b) Limitation on Tax Applicable to Individuals.—In the case of an individual, if the stock sold or exchanged is a capital asset (within the meaning of section 1221) and has been held for more than 1 year, the tax attributable to an amount included in gross income as a dividend under subsection (a) shall not be greater than a tax equal to the sum of—

(1) a pro rata share of the excess of—

(A) the taxes that would have been paid by the foreign corporation with respect to its income had it been taxed under this chapter as a domestic corporation (but without allowance for deduction of, or credit for, taxes described in subparagraph (B)), for the period or periods the stock sold or exchanged was held by the United States person in taxable years beginning after December 31, 1962, while the foreign corporation was a controlled foreign corporation, adjusted for distributions and amounts previously included in gross income of a United States shareholder under section 951, over

(B) the income, war profits, or excess profits taxes paid by the foreign corporation with respect to such income; and

(2) an amount equal to the tax that would result by including in gross income, as gain from the sale or exchange of a capital asset held for more than 1 year, an amount equal to the excess of (A) the amount included in gross income as a dividend under subsection (a), over (B) the amount determined under paragraph (1).

(c) Determination of Earnings and Profits.—

(1) In general.—Except as provided in section 312(k)(4), for purposes of this section, the earnings and profits of any foreign corporation for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary.

(2) Earnings and profits of subsidiaries of foreign corporations.—If—

(A) subsection (a) or (f) applies to a sale, exchange, or distribution by a United States person of stock of a foreign corporation and, by reason of the ownership of the stock sold or exchanged, such person owned within the meaning of section 958(a)(2) stock of any other foreign corporation; and

(B) such person owned, within the meaning of section 958(a), or was considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such other foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such other foreign corporation was a controlled foreign corporation (as defined in section 957),

then, for purposes of this section, the earnings and profits of the foreign corporation the stock of which is sold or exchanged which are attributable to the stock sold or exchanged shall be deemed to include the earnings and profits of such other foreign corporation which—

(C) are attributable (under regulations prescribed by the Secretary) to the stock of such other foreign corporation which such person owned within the meaning of section 958(a)(2) (by reason of his ownership within the meaning of section 958(a)(1)(A) of the stock sold or exchanged) on the date of such sale or exchange (or on the date of any sale or exchange of the stock of such other foreign corporation occurring during the 5-year period ending on the date of the sale or exchange of the stock of such foreign corporation, to the extent not otherwise taken into account under this section but not in excess of the fair market value of the stock of such other foreign corporation sold or exchanged over the basis of such stock (for determining gain) in the hands of the transferor); and

(D) were accumulated in taxable years of such other corporation beginning after December 31, 1962, and during the period or periods—

(i) such other corporation was a controlled foreign corporation, and

(ii) such person owned within the meaning of section 958(a) the stock of such other foreign corporation.

(d) Exclusions from Earnings and Profits.—For purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:

(1) Amounts included in gross income under section 951.—Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 951, with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount from gross income under section 959.

(2) [Repealed].

(3) Less developed country corporations under prior law.—Earnings and profits of a foreign corporation which were accumulated during any taxable year beginning before January 1, 1976, while such corporation was a less developed country corporation under section 902(d) as in effect before the enactment of the Tax Reduction Act of 1975.

(4) United States income.—Any item includible in gross income of the foreign corporation under this chapter—

(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or
(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(5) Foreign trade income.—Earnings and profits of the foreign corporation attributable to foreign trade income of a FSC (as defined in section 922) other than foreign trade income which—

(A) is section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6)), or

(B) would not (but for section 923(a)(4)) be treated as exempt foreign trade income.

For purposes of the preceding sentence, the terms “foreign trade income” and “exempt foreign trade income” have the respective meanings given such terms by section 923. Any reference in this paragraph to section 922, 923, or 927 shall be treated as a reference to such section as in effect before its repeal by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000.

(6) Amounts included in gross income under section 1293.—Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 1293 with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount under section 1293(c).

(c) Sales or Exchanges of Stock in Certain Domestic Corporations.—Except as provided in regulations prescribed by the Secretary, if—

(1) a United States person sells or exchanges stock of a domestic corporation, and

(2) such domestic corporation was formed or availed of principally for the holding, directly or indirectly, of stock of one or more foreign corporations,

such sale or exchange shall, for purposes of this section, be treated as a sale or exchange of the stock of the foreign corporation or corporations held by the domestic corporation.

(f) Certain Nonrecognition Transactions.—Except as provided in regulations prescribed by the Secretary—

(1) In General.—If—

(A) a domestic corporation satisfies the stock ownership requirements of subsection (a)(2) with respect to a foreign corporation, and

(B) such domestic corporation distributes stock of such foreign corporation in a distribution to which section 311(a), 337, 355(c)(1), or 361(c)(1) applies,

then, notwithstanding any other provision of this subtitle, an amount equal to the excess of the fair market value of such stock over its adjusted basis in the hands of the domestic corporation shall be included in the gross income of the domestic corporation as a dividend to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by such domestic corporation while such foreign corporation was a controlled foreign corporation. For purposes of subsections (c)(2), (d), and (h), a distribution of stock to which this subsection applies shall be treated as a sale of stock to which subsection (a) applies.

(2) Exception for certain distributions.—In the case of any distribution of stock of a foreign corporation, paragraph (1) shall not apply if such distribution is to a domestic corporation—

(A) which is treated under this section as holding such stock for the period for which the stock was held by the distributing corporation, and

(B) which, immediately after the distribution, satisfies the stock ownership requirements of subsection (a)(2) with respect to such foreign corporation.

(3) Application to cases described in subsection (e).—To the extent that earnings and profits are taken into account under this subsection, they shall be excluded and not taken into account for purposes of subsection (e).

(g) Exceptions.—This section shall not apply to—

(1) distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies; or

(2) any amount to the extent that such amount is, under any other provision of this title, treated as—

(A) a dividend (other than an amount treated as a dividend under subsection (f)),

(B) ordinary income, or

(C) gain from the sale of an asset held for not more than 1 year.

(h) Taxpayer to Establish Earnings and Profits.—Unless the taxpayer establishes the amount of the earnings and profits of the foreign corporation to be taken into account under subsection (a) or (f), all gain from the sale or exchange shall be considered a dividend under subsection (a) or (f), and unless the
taxpayer establishes the amount of foreign taxes to be taken into account under subsection (b), the limitation of such subsection shall not apply.

(i) Treatment of Certain Indirect Transfers.—

(1) In general.— If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, such 10-percent corporate shareholder shall recognize gain in the same manner as if the stock of the foreign corporation received in such exchange had been—

(A) issued to the 10-percent corporate shareholder, and
(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).

The amount of gain recognized by such 10-percent corporate shareholder under the preceding sentence shall not exceed the amount treated as a dividend under this section.

(2) 10-percent corporate shareholder defined.— For purposes of this subsection, the term “10-percent corporate shareholder” means any domestic corporation which, as of the day before the exchange referred to in paragraph (1), satisfies the stock ownership requirements of subsection (a)(2) with respect to the foreign corporation.

(j) Cross Reference.— For provision excluding amounts previously taxed under this section from gross income when subsequently distributed, see section 959(e).

Section 1249.
Gain from Certain Sales or Exchanges of Patents, Etc., to Foreign Corporations

(a) General Rule.— Gain from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design (whether or not patented), a copyright, a secret formula or process, or any other similar property right to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation shall, if such gain would (but for the provisions of this subsection) be gain from the sale or exchange of a capital asset or of property described in section 1231, be considered as ordinary income.

(b) Control.— For purposes of subsection (a), control means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this subsection, the rules for determining ownership of stock prescribed by section 958 shall apply.

Chapter 3—Withholding of Tax on Nonresident Aliens and Foreign Corporations

Section 1441.
Withholding of Tax on Nonresident Aliens

(a) General Rule.— Except as otherwise provided in subsection (c), all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual or of any foreign partnership shall (except as otherwise provided in regulations prescribed by the Secretary under section 874) deduct and withhold from such items a tax equal to 30 percent thereof, except that in the case of any item of income specified in the second sentence of subsection (b), the tax shall be equal to 14 percent of such item.

(b) Income Items.— The items of income referred to in subsection (a) are interest (other than original issue discount as defined in section 1273), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, gains described in section 631(b) or (c), amounts subject to tax under section 871(a)(1)(C), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966. The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 14 percent are amounts which are received by a nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act and which are—

(1) incident to a qualified scholarship to which section 117(a) applies, but only to the extent includible in gross income; or
(2) in the case of an individual who is not a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii), granted by—

(A) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),
(B) a foreign government,
(C) an international organization, or a binational or multinational educational and cultural foundation or...
commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(D) the United States, or an instrumentality or agency thereof, or a State, or a possession of the United States, or any political subdivision thereof, or the District of Columbia,
as a scholarship or fellowship for study, training, or research in the United States. In the case of a nonresident alien individual who is a member of a domestic partnership, the items of income referred to in subsection (a) shall be treated as referring to items specified in this subsection included in his distributive share of the income of such partnership.

(c) Exceptions.—

(1) Income connected with United States business.— No deduction or withholding under subsection (a) shall be required in the case of any item of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and which is included in the gross income of the recipient under section 871(b)(2) for the taxable year.

(2) Owner unknown.— The Secretary may authorize the tax under subsection (a) to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(3) Bonds with extended maturity dates.— The deduction and withholding in the case of interest on bonds, mortgages, or deeds of trust or other similar obligations of a corporation, within subsections (a), (b), and (c) of section 1451 (as in effect before its repeal by the Tax Reform Act of 1984) were it not for the fact that the maturity date of such obligations has been extended on or after January 1, 1934, and the liability assumed by the debtor exceeds 27-1/2 percent of the interest, shall not exceed the rate of 27-1/2 percent per annum.

(4) Compensation of certain aliens.— Under regulations prescribed by the Secretary, compensation for personal services may be exempted from deduction and withholding under subsection (a).

(5) Special items.— In the case of gains described in section 631(b) or (c), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966, the amount required to be deducted and withheld shall, if the amount of such gain is not known to the withholding agent, be such amount, not exceeding 30 percent of the amount payable, as may be necessary to assure that the tax deducted and withheld shall not be less than 30 percent of such gain.

(6) Per diem of certain aliens.— No deduction or withholding under subsection (a) shall be required in the case of amounts of per diem for subsistence paid by the United States Government (directly or by contract) to any nonresident alien individual who is engaged in any program of training in the United States under the Mutual Security Act of 1954, as amended.

(7) Certain annuities received under qualified plans.— No deduction or withholding under subsection (a) shall be required in the case of any amount received as an annuity if such amount is, under section 871(f), exempt from the tax imposed by section 871(a).

(8) Original issue discount.— The Secretary may prescribe such regulations as may be necessary for the deduction and withholding of the tax on original issue discount subject to tax under section 871(a)(1)(C) including rules for the deduction and withholding of the tax on original issue discount from payments of interest.

(9) Interest income from certain portfolio debt investments.— In the case of portfolio interest (within the meaning of 871(h)), no tax shall be required to be deducted and withheld from such interest unless the person required to deduct and withhold tax from such interest knows, or has reason to know, that such interest is not portfolio interest by reason of section 871(h)(3) or (4).

(10) Exception for certain interest and dividends.— No tax shall be required to be deducted and withheld under subsection (a) from any amount described in section 871(i)(2).

(11) Certain gambling winnings.— No tax shall be required to be deducted and withheld under subsection (a) from any amount exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(j).

(12) Certain dividends received from regulated investment companies.—

(A) In general.— No tax shall be required to be deducted and withheld under subsection (a) from any amount exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(k).

(B) Special rule.— For purposes of subparagraph (A), clause (i) of section 871(k)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B).

(d) Exemption of Certain Foreign Partnerships.— Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary, subsection (a) shall not apply in the case of a foreign partnership engaged in trade or business within the United States if the Secretary determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section
871(a) on the members of such partnership who are nonresident alien individuals will not be jeopardized by the exemption.

(e) **Alien Resident of Puerto Rico.**—For purposes of this section, the term “nonresident alien individual” includes an alien resident of Puerto Rico.

(f) **Continental Shelf Areas.**—For sources of income derived from, or for services performed with respect to, the exploration or exploitation of natural resources on submarine areas adjacent to the territorial waters of the United States, see section 638.

(g) **Cross Reference.**—For provision treating 85 percent of social security benefits as subject to withholding under this section, see section 871(a)(3).

**Section 1442.**

**Withholding of Tax on Foreign Corporations**

(a) **General Rule.**—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 a tax equal to 30 percent thereof. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1)(C) and (D) shall be treated as referring to sections 881(a)(3) and (4), the reference in section 1441(c)(1) to section 871(b)(2) shall be treated as referring to section 842 or section 882(a)(2), as the case may be, the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881(a)(4), the reference in section 1441(c)(8) to section 871(a)(1)(C) shall be treated as referring to section 881(a)(3), the references in section 1441(c)(9) to sections 871(h) and 871(h)(3) or (4) shall be treated as referring to sections 881(c) and 881(c)(3) or (4), the reference in section 1441(c)(10) to section 871(i)(2) shall be treated as referring to section 881(d), and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause).

(b) **Exemption.**—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption.

(c) **Exception for Certain Possessions Corporations.**—

(1) **Guam, American Samoa, the Northern Mariana Islands, and the Virgin Islands.**—For purposes of this section, the term “foreign corporation” does not include a corporation created or organized in Guam, American Samoa, the Northern Mariana Islands, or the Virgin Islands or under the law of any such possession if the requirements of subparagraphs (A), (B), and (C) of section 881(b)(1) are met with respect to such corporation.

(2) **Commonwealth of Puerto Rico.**—

(A) **In general.**—If dividends are received during a taxable year by a corporation—

(i) created or organized in, or under the law of, the Commonwealth of Puerto Rico, and

(ii) with respect to which the requirements of subparagraphs (A), (B), and (C) of section 881(b)(1) are met for the taxable year, subsection (a) shall be applied for such taxable year by substituting ‘10 percent’ for ‘30 percent’.

(B) **Applicability.**—If, on or after the date of the enactment of this paragraph, an increase in the rate of the Commonwealth of Puerto Rico’s withholding tax which is generally applicable to dividends paid to United States corporations not engaged in a trade or business in the Commonwealth to a rate greater than 10 percent takes effect, this paragraph shall not apply to dividends received on or after the effective date of the increase.

**Section 1445.**

**Withholding of Tax on Dispositions of United States Real Property Interests**

(a) **General Rule.**—Except as otherwise provided in this section, in the case of any disposition of a United States real property interest (as defined in section 897(c)) by a foreign person, the transferee shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

(b) **Exemptions.**—

(1) **In general.**—No person shall be required to deduct and withhold any amount under subsection (a) with respect to a disposition if paragraph (2), (3), (4), (5), or (6) applies to the transaction.

(2) **Transferor furnishes nonforeign affidavit.**—Except as provided in paragraph (7), this paragraph applies to
the disposition if the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty of perjury, that the transferor is not a foreign person.

(3) Nonpublicly traded domestic corporation furnishes affidavit that interests in corporation not United States real property interests.— Except as provided in paragraph (7), this paragraph applies in the case of a disposition of any interest in any domestic corporation if the domestic corporation furnishes to the transferee an affidavit by the domestic corporation stating, under penalty of perjury, that—

(A) the domestic corporation is not and has not been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii), or

(B) as of the date of the disposition, interests in such corporation are not United States real property interests by reason of section 897(c)(1)(B).

(4) Transferee receives qualifying statement.—

(A) In general.— This paragraph applies to the disposition if the transferee receives a qualifying statement at such time, in such manner, and subject to such terms and conditions as the Secretary may by regulations prescribe.

(B) Qualifying statement.— For purposes of subparagraph (A), the term “qualifying statement” means a statement by the Secretary that—

(i) the transferor either—

(I) has reached agreement with the Secretary (or such agreement has been reached by the transferee) for the payment of any tax imposed by section 871(b)(1) or 882(a)(1) on any gain recognized by the transferor on the disposition of the United States real property interest, or

(II) is exempt from any tax imposed by section 871(b)(1) or 882(a)(1) on any gain recognized by the transferor on the disposition of the United States real property interest, and

(ii) the transferor or transferee has satisfied any transferor’s unsatisfied withholding liability or has provided adequate security to cover such liability.

(5) Residence where amount realized does not exceed $300,000.— This paragraph applies to the disposition if—

(A) the property is acquired by the transferee for use by him as a residence, and

(B) the amount realized for the property does not exceed $300,000.

(6) Stock regularly traded on established securities market.— This paragraph applies if the disposition is of a share of a class of stock that is regularly traded on an established securities market.

(7) Special rules for paragraphs (2), (3), and (9).— Paragraph (2), (3), or (9) (as the case may be) shall not apply to any disposition—

(A) if—

(i) the transferee or qualified substitute has actual knowledge that the affidavit referred to in such paragraph, or the statement referred to in paragraph (9)(A)(ii), is false, or

(ii) the transferee or qualified substitute receives a notice (as described in subsection (d)) from a transferor’s agent, transferee’s agent, or qualified substitute that such affidavit or statement is false, or

(B) if the Secretary by regulations requires the transferee or qualified substitute to furnish a copy of such affidavit or statement to the Secretary and the transferee or qualified substitute fails to furnish a copy of such affidavit or statement to the Secretary at such time and in such manner as required by such regulations.

(8) Applicable wash sales transactions.— No person shall be required to deduct and withhold any amount under subsection (a) with respect to a disposition which is treated as a disposition of a United States real property interest solely by reason of section 897(h)(5).

(9) Alternative procedure for furnishing nonforeign affidavit.— For purposes of paragraphs (2) and (7)—

(A) In general.— Paragraph (2) shall be treated as applying to a transaction if, in connection with a disposition of a United States real property interest solely by reason of section 897(h)(5).

(c) Limitations on Amount Required to be Withheld.—

(1) Cannot exceed transferor’s maximum tax liability.—

(A) In general.— The amount required to be withheld under this section with respect to any disposition shall not exceed the amount (if any) determined under subparagraph (B) as the transferor’s maximum tax liability.
(B) Request.— At the request of the transferor or transferee, the Secretary shall determine, with respect to any disposition, the transferor’s maximum tax liability.

(C) Refund of excess amounts withheld.— Subject to such terms and conditions as the Secretary may by regulations prescribe, a transferee may seek and obtain a refund of any amounts withheld under this section in excess of the transferor’s maximum tax liability.

(2) Authority of Secretary to prescribe reduced amount.— At the request of the transferor or transferee, the Secretary may prescribe a reduced amount to be withheld under this section if the Secretary determines that to substitute such reduced amount will not jeopardize the collection of the tax imposed by section 871(b)(1) or 882(a)(1).

(3) Procedural rules.—

(A) Regulations.— Requests for—

(i) qualifying statements under subsection (b)(4),

(ii) determinations of transferor’s maximum tax liability under paragraph (1), and

(iii) reductions under paragraph (2) in the amount required to be withheld,

shall be made at the time and manner, and shall include such information, as the Secretary shall prescribe by regulations.

(B) Requests to be handled within 90 days.— The Secretary shall take action with respect to any request described in subparagraph (A) within 90 days after the Secretary receives the request.

(d) Liability of Transferor’s Agents or Transferee’s Agents.—

(1) Notice of false affidavit; foreign corporations.— If—

(A) the transferor furnishes the transferee an affidavit described in paragraph (2) of subsection (b) or a domestic corporation furnishes the transferee an affidavit described in paragraph (3) of subsection (b), and

(B) in the case of—

(i) any transferor’s agent—

(I) such agent has actual knowledge that such affidavit is false, or

(II) in the case of an affidavit described in subsection (b)(2) furnished by a corporation, such corporation is a foreign corporation, or

(ii) any transferee’s agent, such agent has actual knowledge that such affidavit is false,

such agent shall so notify the transferee at such time and in such manner as the Secretary shall require by regulations.

(2) Failure to furnish notice.—

(A) In general.— If any transferor’s agent or transferee’s agent is required by paragraph (1) to furnish notice, but fails to furnish such notice at such time or times and in such manner as may be required by regulations, such agent shall have the same duty to deduct and withhold that the transferee would have had if such agent had complied with paragraph (1).

(B) Liability limited to amount of compensation.— An agent’s liability under subparagraph (A) shall be limited to the amount of compensation the agent derives from the transaction.

(3) Transferor’s agent.— For purposes of this subsection, the term “transferor’s agent” means any person who represents the transferor—

(A) in any negotiation with the transferee or any transferee’s agent related to the transaction, or

(B) in settling the transaction.

(4) Transferee’s agent.— For purposes of this subsection, the term “transferee’s agent” means any person who represents the transferee—

(A) in any negotiation with the transferor or any transferor’s agent related to the transaction, or

(B) in settling the transaction.

(5) Settlement officer not treated as transferor’s agent.— For purposes of this subsection, a person shall not be treated as a transferor’s agent or transferee’s agent with respect to any transaction merely because such person performs 1 or more of the following acts:

(A) The receipt and the disbursement of any portion of the consideration for the transaction.

(B) The recording of any document in connection with the transaction.

(e) Special Rules Relating to Distributions, Etc., by Corporations, Partnerships, Trusts, or Estates.—

(1) Certain domestic partnerships, trusts, and estates.— In the case of any disposition of a United States real property interest as defined in section 897(c) (other than a disposition described in paragraph (4) or (5)) by a domestic partnership, domestic trust, or domestic estate, such partnership, the trustee of such trust, or the executor of such estate (as the case may be) shall be required to deduct and withhold under subsection (a) a tax equal to 35 percent (or, to the extent provided in regulations, 15 percent) of the gain realized to the extent such gain—
(A) is allocable to a foreign person who is a partner or beneficiary of such partnership, trust, or estate, or

(B) is allocable to a portion of the trust treated as owned by a foreign person under subpart E of part I of subchapter J.

(2) Certain distributions by foreign corporations.—In the case of any distribution by a foreign corporation on which gain is recognized under subsection (d) or (e) of section 897, the foreign corporation shall deduct and withhold under subsection (a) a tax equal to 35 percent of the amount of gain recognized on such distribution under such subsection.

(3) Distributions by certain domestic corporations to foreign shareholders.—If a domestic corporation which is or has been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii) distributes property to a foreign person in a transaction to which section 302 or part II of subchapter C applies, such corporation shall deduct and withhold under subsection (a) a tax equal to 10 percent of the amount realized by the foreign shareholder. The preceding sentence shall not apply, as of the date of the distribution, in interests in such corporation that are not United States real property interests by reason of section 897(c)(1)(B). Rules similar to the rules of the preceding provisions of this paragraph shall apply in any distribution to which section 301 applies and which is not made out of the earnings and profits of such a domestic corporation.

(4) Taxable distributions by domestic or foreign partnerships, trusts, or estates.—A domestic or foreign partnership, the trustee of a domestic or foreign trust, or the executor of a domestic or foreign estate shall be required to deduct and withhold under subsection (a) a tax equal to 10 percent of the fair market value (as of the time of the taxable distribution) of any United States real property interest distributed to a partner of the partnership or a beneficiary of the trust or estate, as the case may be, who is a foreign person in a transaction which would constitute a taxable transaction under the regulations promulgated by the Secretary pursuant to section 897.

(5) Rules relating to dispositions of interest in partnerships, trusts, or estates.—To the extent provided in regulations, the transferee of a partnership interest or of a beneficial interest in a trust or estate shall be required to deduct and withhold under subsection (a) a tax equal to 10 percent of the amount realized on the disposition.

(6) Distributions by regulated investment companies and real estate investment trusts.—If any portion of a distribution from a qualified investment entity (as defined in section 897(h)(4)) to a nonresident alien individual or a foreign corporation is treated under section 897(h)(1) as gain realized by such individual or corporation from the sale or exchange of a United States real property interest, the qualified investment entity shall deduct and withhold under subsection (a) a tax equal to 35 percent (or, to the extent provided in regulations, 15 percent (20 percent in the case of taxable years beginning after December 31, 2010)) of the amount so treated.

(7) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations providing for exceptions from provisions of this subsection and regulations for the application of this subsection in the case of payments through 1 or more entities.

(f) Definitions.—For purposes of this section—

(1) Transferor.—The term “transferor” means the person disposing of the United States real property interest.

(2) Transferee.—The term “transferee” means the person acquiring the United States real property interest.

(3) Foreign person.—The term “foreign person” means any person other than a United States person.

(4) Transferor’s maximum tax liability.—The term “transferor’s maximum tax liability” means, with respect to the disposition of any interest, the sum of—

(A) the maximum amount which the Secretary determines could be imposed as tax under section 871(b)(1) or 882(a)(1) by reason of the disposition, plus

(B) the amount the Secretary determines to be the transferor’s unsatisfied withholding liability with respect to such interest.

(5) Transferor’s unsatisfied withholding liability.—The term “transferor’s unsatisfied withholding liability” means the withholding obligation imposed by this section on the transferor’s acquisition of the United States real property interest or on the acquisition of a predecessor interest, to the extent such obligation has not been satisfied.
(b) **Amount of Withholding Tax.**—

(1) **In general.**— The amount of the withholding tax payable by any partnership under subsection (a) shall be equal to the applicable percentage of the effectively connected taxable income of the partnership which is allocable under section 704 to foreign partners.

(2) **Applicable percentage.**— For purposes of paragraph (1), the term “applicable percentage” means—

(A) the highest rate of tax specified in section 1 in the case of the portion of the effectively connected taxable income which is allocable under section 704 to foreign partners who are not corporations, and

(B) the highest rate of tax specified in section 11(b)(1) in the case of the portion of the effectively connected taxable income which is allocable under section 704 to foreign partners which are corporations.

(c) **Effectively Connected Taxable Income.**— For purposes of this section, the term “effectively connected taxable income” means the taxable income of the partnership which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States computed with the following adjustments:

(1) Paragraph (1) of section 703(a) shall not apply.

(2) The partnership shall be allowed a deduction for depletion with respect to oil and gas wells but the amount of such deduction shall be determined without regard to sections 613 and 613A.

(3) There shall not be taken into account any item of income, gain, loss, or deduction to the extent allocable under section 704 to any partner who is not a foreign partner.

(d) **Treatment of Foreign Partners.**—

(1) **Allowance of credit.**— Each foreign partner of a partnership shall be allowed a credit under section 33 for such partner’s share of the withholding tax paid by the partnership under this section. Such credit shall be allowed for the partner’s taxable year in which (or with which) the partnership taxable year (for which such tax was paid) ends.

(2) **Credit treated as distributed to partner.**— Except as provided in regulations, a foreign partner’s share of any withholding tax paid by the partnership under this section shall be treated as distributed to such partner by such partnership on the earlier of—

(A) the day on which such tax was paid by the partnership, or

(B) the last day of the partnership’s taxable year for which such tax was paid.

(e) **Foreign Partner.**— For purposes of this section, the term “foreign partner” means any partner who is not a United States person.

(f) **Regulations.**— The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including—

(1) regulations providing for the application of this section in the case of publicly traded partnerships, and

(2) regulations providing—

(A) that, for purposes of section 6655, the withholding tax imposed under this section shall be treated as a tax imposed by section 11 and any partnership required to pay such tax shall be treated as a corporation, and

(B) appropriate adjustments in applying section 6655 with respect to such withholding tax.

Section 1461.
Liability for Withheld Tax

Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter.

Subtitle F—Procedure and Administration

[§§ 6001—7654]

Section 6013.
Joint Returns of Income Tax by Husband and Wife

(a) **Joint Returns.**— A husband and wife may make a single return jointly of income taxes under subtitle A, even though one of the spouses has neither gross income nor deductions, except as provided below:

(1) no joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien; * * *

(d) **Special Rules.**— For purposes of this section—

(1) the status as husband and wife of two individuals having taxable years beginning on the same day shall be determined—

(A) if both have the same taxable year—as of the close of such year; or
(B) if one dies before the close of the taxable year of the other—as of the time of such death;

(2) an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married; and

(3) if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

* * *

(g) Election to Treat Nonresident Alien Individual as Resident of the United States.—

(1) In general.— A nonresident alien individual with respect to whom this subsection is in effect for the taxable year shall be treated as a resident of the United States—

(A) for purposes of chapter 1 for all of such taxable year, and

(B) for purposes of chapter 24 (relating to wage withholding) for payments of wages made during such taxable year.

(2) Individuals with respect to whom this subsection is in effect.— This subsection shall be in effect with respect to any individual who, at the close of the taxable year for which an election under this subsection was made, was a nonresident alien individual married to a citizen or resident of the United States, if both of them made such election to have the benefits of this subsection apply to them.

(3) Duration of election.— An election under this subsection shall apply to the taxable year for which made and to all subsequent taxable years until terminated under paragraph (4) or (5); except that any such election shall not apply for any taxable year if neither spouse is a citizen or resident of the United States at any time during such year.

(4) Termination of election.— An election under this subsection shall terminate at the earliest of the following times:

(A) Revocation by taxpayers.— If either taxpayer revokes the election, as of the first taxable year for which the last day prescribed by law for filing the return of tax under chapter 1 has not yet occurred.

(B) Death.— In the case of the death of either spouse, as of the beginning of the first taxable year of the spouse who survives following the taxable year in which such death occurred; except that if the spouse who survives is a citizen or resident of the United States who is a surviving spouse entitled to the benefits of section 2, the time provided by this subparagraph shall be as of the close of the last taxable year for which such individual is entitled to the benefits of section 2.

(C) Legal separation.— In the case of the legal separation of the couple under a decree of divorce or of separate maintenance, as of the beginning of the taxable year in which such legal separation occurs.

(D) Termination by Secretary.— At the time provided in paragraph (5).

(5) Termination by Secretary.— The Secretary may terminate any election under this subsection for any taxable year if he determines that either spouse has failed—

(A) to keep such books and records,

(B) to grant such access to such books and records, or

(C) to supply such other information, as may be reasonably necessary to ascertain the amount of liability for taxes under chapter 1 of either spouse for such taxable year.

(6) Only one election.— If any election under this subsection for any two individuals is terminated under paragraph (4) or (5) for any taxable year, such two individuals shall be ineligible to make an election under this subsection for any subsequent taxable year.

(h) Joint Return, Etc., for Year in Which Nonresident Alien Becomes Resident of United States.—

(1) In general.— If—

(A) any individual is a nonresident alien individual at the beginning of any taxable year but is a resident of the United States at the close of such taxable year,

(B) at the close of such taxable year, such individual is married to a citizen or resident of the United States, and

(C) both individuals elect the benefits of this subsection at the time and in the manner prescribed by the Secretary by regulation,

then the individual referred to in subparagraph (A) shall be treated as a resident of the United States for purposes of chapter 1 for all of such taxable year, and for purposes of chapter 24 (relating to wage withholding) for payments of wages made during such taxable year.

(2) Only one election.— If any election under this subsection applies for any 2 individuals for any taxable year, such 2 individuals shall be ineligible to make an election under this subsection for any subsequent taxable year.

Section 6039E.

Information Concerning Resident Status

(a) General Rule.— Notwithstanding any other provision of law, any individual who—

(1) applies for a United States passport (or a renewal thereof), or
(2) applies to be lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, shall include with any such application a statement which includes the information described in subsection (b).

(b) INFORMATION TO BE PROVIDED.— Information required under subsection (a) shall include—

(1) the taxpayer’s TIN (if any),
(2) in the case of a passport applicant, any foreign country in which such individual is residing,
(3) in the case of an individual seeking permanent residence, information with respect to whether such individual is required to file a return of the tax imposed by chapter 1 for such individual’s most recent 3 taxable years, and
(4) such other information as the Secretary may prescribe.

(c) PENALTY.— Any individual failing to provide a statement required under subsection (a) shall be subject to a penalty equal to $500 for each such failure, unless it is shown that such failure is due to reasonable cause and not to willful neglect.

(d) INFORMATION TO BE PROVIDED TO SECRETARY.— Notwithstanding any other provision of law, any agency of the United States which collects (or is required to collect) the statement under subsection (a) shall—

(1) provide any such statement to the Secretary, and
(2) provide to the Secretary the name (and any other identifying information) of any individual refusing to comply with the provisions of subsection (a).

Nothing in the preceding sentence shall be construed to require the disclosure of information which is subject to section 245A of the Immigration and Nationality Act (as in effect on the date of the enactment of this sentence).

(e) EXEMPTION.— The Secretary may by regulations exempt any class of individuals from the requirements of this section if he determines that applying this section to such individuals is not necessary to carry out the purposes of this section.

Section 6039G.
Information on Individuals Losing United States Citizenship

(a) IN GENERAL.— Notwithstanding any other provision of law, any individual to whom section 877(b) or 877A applies for any taxable year shall provide a statement for such taxable year which includes the information described in subsection (b).

(b) INFORMATION TO BE PROVIDED.— Information required under subsection (a) shall include—

(1) the taxpayer’s TIN,
(2) the mailing address of such individual’s principal foreign residence,
(3) the foreign country in which such individual is residing,
(4) the foreign country of which such individual is a citizen,
(5) information detailing the income, assets, and liabilities of such individual,
(6) the number of days during any portion of which that the individual was physically present in the United States during the taxable year, and
(7) such other information as the Secretary may prescribe.

(c) PENALTY.— If—

(1) an individual is required to file a statement under subsection (a) for any taxable year, and
(2) fails to file such a statement with the Secretary on or before the date such statement is required to be filed or fails to include all the information required to be shown on the statement or includes incorrect information,

such individual shall pay a penalty of $10,000 unless it is shown that such failure is due to reasonable cause and not to willful neglect.

(d) INFORMATION TO BE PROVIDED TO SECRETARY.— Notwithstanding any other provision of law—

(1) any Federal agency or court which collects (or is required to collect) the statement under subsection (a) shall provide to the Secretary—

(A) a copy of any such statement, and
(B) the name (and any other identifying information) of any individual refusing to comply with the provisions of subsection (a),
(2) the Secretary of State shall provide to the Secretary a copy of each certificate as to the loss of American nationality under section 358 of the Immigration and Nationality Act which is approved by the Secretary of State, and
(3) the Federal agency primarily responsible for administering the immigration laws shall provide to the Secretary the name of each lawful permanent resident of the United States (within the meaning of section 7701(b)(6) whose status as such has been revoked or has been
Section 6041. Information at Source

(a) Payments of $600 or More.—All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments to which section 6042(a)(1), 6044(a)(1), 6047(e), 6049(a), or 6050N(a) applies, and other than payments with respect to which a statement is required under the authority of section 6042(a)(2), 6044(a)(2), or 6045), or $600 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) Collection of Foreign Items.—In the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by any person undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange, such person shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the amount paid and the name and address of the recipient of each such payment.

(c) Recipient to Furnish Name and Address.—When necessary to make effective the provisions of this section, the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(d) Statements to Be Furnished to Persons with Respect to Whom Information is Required.—Every person required to make a return under subsection (a) shall furnish to each person with respect to whom such a return is required a written statement showing—

(1) the name and address of the person required to make such return, and

(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under
subsection (a) was required to be made. To the extent provided in regulations prescribed by the Secretary, this subsection shall also apply to persons required to make returns under subsection (b).

(e) Section Does Not Apply to Certain Tips.—This section shall not apply to tips with respect to which section 6053(a) (relating to reporting of tips) applies.

(f) Section Does Not Apply to Certain Health Arrangements.—This section shall not apply to any payment for medical care (as defined in section 106(c)(2)), or

(1) a flexible spending arrangement (as defined in section 106(c)(2)), or
(2) a health reimbursement arrangement which is treated as employer-provided coverage under an accident or health plan for purposes of section 106.

(g) Nonqualified Deferred Compensation.—Subsection (a) shall apply to—

(1) any deferrals for the year under a nonqualified deferred compensation plan (within the meaning of section 409A(d)), whether or not paid, except that this paragraph shall not apply to deferrals which are required to be reported under section 6051(a)(13) (without regard to any de minimis exception), and
(2) any amount includible under section 409A and which is not treated as wages under section 3401(a).

Section 6105.
Confidentiality of information arising under treaty obligations

(a) In general.—Tax convention information shall not be disclosed.

(b) Exceptions.—Subsection (a) shall not apply—

(1) to the disclosure of tax convention information to persons or authorities (including courts and administrative bodies) which are entitled to such disclosure pursuant to a tax convention,
(2) to any generally applicable procedural rules regarding applications for relief under a tax convention,
(3) to the disclosure of tax convention information on the same terms as return information may be disclosed under paragraph (3)(C) or (7) of section 6103(i), except that in the case of tax convention information provided by a foreign government, no disclosure may be made under this paragraph without the written consent of the foreign government, or
(4) in any case not described in paragraphs (1), (2), or (3), to the disclosure of any tax convention information not relating to a particular taxpayer if the Secretary determines, after consultation with each other party to the tax convention, that such disclosure would not impair tax administration.

(c) Definitions.—For purposes of this section—

(1) Tax convention information.—The term “tax convention information” means any—

(A) agreement entered into with the competent authority of one or more foreign governments pursuant to a tax convention,
(B) application for relief under a tax convention,
(C) any background information related to such agreement or application,
(D) document implementing such agreement, and
(E) any other information exchanged pursuant to a tax convention which is treated as confidential or secret under the tax convention.
(2) Tax convention.—The term “tax convention” means—

(A) any income tax or gift and estate tax convention, or
(B) any other convention or bilateral agreement (including multilateral conventions and agreements and any agreement with a possession of the United States) providing for the avoidance of double taxation, the prevention of fiscal evasion, nondiscrimination with respect to taxes, the exchange of tax relevant information with the United States, or mutual assistance in tax matters.

(d) Cross references.—For penalties for the unauthorized disclosure of tax convention information which is return or return information, see sections 7213, 7213A, and 7431.

Section 6114.
Treaty-based Return Positions

(a) In General.—Each taxpayer who, with respect to any tax imposed by this title, takes the position that a treaty of the United States overrules (or otherwise modifies) an internal revenue law of the United States shall disclose (in such manner as the Secretary may prescribe) such position—

(1) on the return of tax for such tax (or any statement attached to such return), or
(2) if no return of tax is required to be filed, in such form as the Secretary may prescribe.
(b) **Waiver Authority.**— The Secretary may waive the requirements of subsection (a) with respect to classes of cases for which the Secretary determines that the waiver will not impede the assessment and collection of tax.

**Section 6662. Imposition of Accuracy-Related Penalty on Underpayments**

(a) **Imposition of Penalty.**— If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(b) **Portion of Underpayment to Which Section Applies.**— This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:

1. Negligence or disregard of rules or regulations.
2. Any substantial understatement of income tax.
3. Any substantial valuation misstatement under chapter 1.
4. Any substantial overstatement of pension liabilities.
5. Any substantial estate or gift tax valuation understatement.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663. Except as provided in paragraph (1) or (2)(B) of section 6662A(e), this section shall not apply to the portion of any underpayment which is attributable to a reportable transaction understatement on which a penalty is imposed under section 6662A.

(c) **Negligence.**— For purposes of this section, the term “negligence” includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term “disregard” includes any careless, reckless, or intentional disregard.

(d) **Substantial Understatement of Income Tax.**—

1. **Substantial understatement.**—

   (A) **In general.**— For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of—

   (i) 10 percent of the tax required to be shown on the return for the taxable year, or
   (ii) $5,000.

   (B) **Special rule for corporations.**— In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of—

   (i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or
   (ii) $10,000,000.

2. **Understatement.**—

   (A) **In general.**— For purposes of paragraph (1), the term “understatement” means the excess of—

   (i) the amount of the tax required to be shown on the return for the taxable year, over
   (ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

   The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

   (B) **Reduction for understatement due to position of taxpayer or disclosed item.**— The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to—

   (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or
   (ii) any item if—

   (I) the relevant facts affecting the item’s tax treatment are adequately disclosed in the return or in a statement attached to the return, and
   (II) there is a reasonable basis for the tax treatment of such item by the taxpayer.

   For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.

   (C) **Special rules in cases involving tax shelters.**—

   (i) **In general.**— In the case of any item of a taxpayer other than a corporation which is attributable to a tax shelter—

   (I) subparagraph (B)(ii) shall not apply, and
   (II) subparagraph (B)(i) shall not apply unless (in addition to meeting the requirements of such subparagraph) the taxpayer reasonably believed that the tax treatment of such item by the taxpayer was more likely than not the proper treatment.
Subparagraph (B) not to apply to corporations.— Subparagraph (B) shall not apply to any item of a corporation which is attributable to a tax shelter.

Tax shelter.— For purposes of this subparagraph, the term “tax shelter” means—

(I) a partnership or other entity,
(II) any investment plan or arrangement, or
(III) any other plan or arrangement,

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

(D) [Repealed]

(3) Secretarial list.— The Secretary may prescribe a list of positions which the Secretary believes do not meet 1 or more of the standards specified in paragraph (2)(B)(i), section 6664(d)(2), and section 6694(a)(1). Such list (and any revisions thereof) shall be published in the Federal Register or the Internal Revenue Bulletin.

(e) Substantial Valuation Misstatement under Chapter 1.—

(1) In general.— For purposes of this section, there is a substantial valuation misstatement under chapter 1 if—

(A) the value of any property (or the adjusted basis of any property) claimed on any return of tax imposed by chapter 1 is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be), or

(B) (i) the price for any property or services (or for the use of property) claimed on any such return in connection with any transaction between persons described in section 482 is 200 percent or more (or 50 percent or less) of the amount determined under section 482 to be the correct amount of such price, or

(ii) the net section 482 transfer price adjustment for the taxable year exceeds the lesser of $5,000,000 or 10 percent of the taxpayer’s gross receipts.

(2) Limitation.— No penalty shall be imposed by reason of subsection (b)(3) unless the portion of the underpayment for the taxable year attributable to substantial valuation misstatements under chapter 1 exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company (as defined in section 542)).

(3) Net section 482 transfer price adjustment.— For purposes of this subsection—

(A) In general.— The term “net section 482 transfer price adjustment” means with respect to any taxable year, the net increase in taxable income for the taxable year (determined without regard to any amount carried to such taxable year from another taxable year) resulting from adjustments under section 482 in the price for any property or services (or for the use of property).

(B) Certain adjustments excluded in determining threshold.— For purposes of determining whether the threshold requirements of paragraph (1)(B)(ii) are met, the following shall be excluded:

(i) Any portion of the net increase in taxable income referred to in subparagraph (A) which is attributable to any redetermination of a price if—

(I) it is established that the taxpayer determined such price in accordance with a specific pricing method set forth in the regulations prescribed under section 482 and that the taxpayer’s use of such method was reasonable,

(II) the taxpayer has documentation (which was in existence as of the time of filing the return) which sets forth the determination of such price in accordance with such a method and which establishes that the use of such method was reasonable, and

(III) the taxpayer provides such documentation to the Secretary within 30 days of request for such documentation.

(ii) Any portion of the net increase in taxable income referred to in subparagraph (A) which is attributable to a redetermination of price where such price was not determined in accordance with such a specific pricing method if—

(I) the taxpayer establishes that none of such pricing methods was likely to result in a price that would clearly reflect income, the taxpayer used another pricing method to determine such price, and such other pricing method was likely to result in a price that would clearly reflect income,

(II) the taxpayer has documentation (which was in existence as of the time of filing the return) which sets forth the determination of such price in accordance with such other method and which establishes that the requirements of subclause (I) were satisfied, and

(III) the taxpayer provides such documentation to the Secretary within 30 days of request for such documentation.

(iii) Any portion of such net increase which is attributable to any transaction solely between foreign corporations unless, in the case of any such corporations, the treatment of such transaction affects the determination of income from sources within the United States or taxable income effectively connected.
with the conduct of a trade or business within the United States.

(C) Special rule.– If the regular tax (as defined in section 55(c)) imposed by chapter 1 on the taxpayer is determined by reference to an amount other than taxable income, such amount shall be treated as the taxable income of such taxpayer for purposes of this paragraph.

(D) Coordination with reasonable cause exception.– For purposes of section 6664(c) the taxpayer shall not be treated as having reasonable cause for any portion of an underpayment attributable to a net section 482 transfer price adjustment unless such taxpayer meets the requirements of clause (i), (ii), or (iii) of subparagraph (B) with respect to such portion.

* * *

(h) Increase in Penalty in Case of Gross Valuation Misstatements.–

(1) In general.– To the extent that a portion of the underpayment to which this section applies is attributable to one or more gross valuation misstatements, subsection (a) shall be applied with respect to such portion by substituting “40 percent” for “20 percent”.

(2) Gross valuation misstatements.– The term “gross valuation misstatements” means—

(A) any substantial valuation misstatement under chapter 1 as determined under subsection (e) by substituting—
   (i) in paragraph (1)(A), “200 percent” for “150 percent”,
   (ii) in paragraph (1)(B)(i)—
      (I) “400 percent” for “200 percent”, and
      (II) “25 percent” for “50 percent”, and
   (iii) in paragraph (1)(B)(ii)—
      (I) “$20,000,000” for “$5,000,000”, and
      (II) “20 percent” for “10 percent”.

(B) any substantial overstatement of pension liabilities as determined under subsection (f) by substituting “400 percent” for “200 percent”, and

(C) any substantial estate or gift tax valuation understatement as determined under subsection (g) by substituting “40 percent” for “65 percent”.

Section 6689.
Failure to File Notice of Redetermination of Foreign Tax

(a) Civil Penalty.– If the taxpayer fails to notify the Secretary (on or before the date prescribed by regulations for giving such notice) of a foreign tax redetermination, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the deficiency attributable to such redetermination an amount (not in excess of 25 percent of the deficiency) determined as follows—

(1) 5 percent of the deficiency if the failure is for not more than 1 month, with

(2) an additional 5 percent of the deficiency for each month (or fraction thereof) during which the failure continues.

(b) Foreign Tax Redetermination Defined.– For purposes of this section, the term “foreign tax redetermination” means any redetermination for which a notice is required under subsection (c) of section 905 or paragraph (2) of section 404A(g).

Section 6712.
Failure to Disclose Treaty-based Return Positions

(a) General Rule.– If a taxpayer fails to meet the requirements of section 6114, there is hereby imposed a penalty equal to $1,000 ($10,000 in the case of a C corporation) on each such failure.

(b) Authority to Waive.– The Secretary may waive all or any part of the penalty provided by this section on a showing by the taxpayer that there was reasonable cause for the failure and that the taxpayer acted in good faith.

(c) Penalty in Addition to Other Penalties.– The penalty imposed by this section shall be in addition to any other penalty imposed by law.

Section 7001.
Collection of Foreign Items

(a) License.– All persons undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Secretary and shall be subject to such regulations enabling the Government to obtain the information
required under subtitle A (relating to income taxes) as the Secretary shall prescribe.

(b) Penalty for Failure to Obtain License.—For penalty for failure to obtain the license provided for in this section, see section 7231.

Subtitle F—Procedure and Administration

Chapter 79—Definitions

Section 7701.
Definitions

[§ 7701(a)—Definitions]

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—.

(1) Person.—The term “person” shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

(2) Partnership and partner.—The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) Corporation.—The term “corporation” includes associations, joint-stock companies, and insurance companies.

(4) Domestic.—The term “domestic” when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations.

(5) Foreign.—The term “foreign” when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) Fiduciary.—The term “fiduciary” means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) Stock.—The term “stock” includes shares in an association, joint-stock company, or insurance company.

(8) Shareholder.—The term “shareholder” includes a member in an association, joint-stock company, or insurance company.

(9) United States.—The term “United States” when used in a geographical sense includes only the States and the District of Columbia.

(10) State.—The term “State” shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

(11) Secretary of the Treasury and Secretary.—

(A) Secretary of the Treasury.—The term “Secretary of the Treasury” means the Secretary of the Treasury, personally, and shall not include any delegate of his.

(B) Secretary.—The term “Secretary” means the Secretary of the Treasury or his delegate.

(12) Delegate.—

(A) In general.—The term “or his delegate”—

(i) when used with reference to the Secretary of the Treasury, means any officer, employee, or agency of the Treasury Department duly authorized by the Secretary of the Treasury directly, or indirectly by one or more redelegations of authority, to perform the function mentioned or described in the context; and

(ii) when used with reference to any other official of the United States, shall be similarly construed.

(B) Performance of certain functions in Guam or American Samoa.—The term “delegate,” in relation to the performance of functions in Guam or American Samoa with respect to the taxes imposed by chapters 1, 2, and 21, also includes any officer or employee of any other department or agency of the United States, or of any possession thereof, duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform such functions.

(13) Commissioner.—The term “Commissioner” means the Commissioner of Internal Revenue.

(14) Taxpayer.—The term “taxpayer” means any person subject to any internal revenue tax.

* * *

(16) Withholding agent.—The term “withholding agent” means any person required to deduct and withhold any tax under the provisions of section 1441, 1442, 1443, or 1461.

(17) Husband and wife.—As used in sections 152(b)(4), 682, and 2516, if the husband and wife therein referred to are divorced, wherever appropriate to the meaning of such sections, the term “wife” shall be read “former wife” and the term “husband” shall be read “former husband”; and, if the payments described in such sections are made by or on behalf of the wife or former wife to the husband or former husband instead of vice versa, wherever appropriate to the meaning of such sections, the term “husband” shall be read “wife” and the term “wife” shall be read “husband.”

(18) International organization.—The term “international organization” means a public international organization entitled to enjoy privileges, exemptions, and immu-
ities as an international organization under the International Organizations Immunities Act (22 U.S.C. 288-288f).

(23) **Taxable year.**— The term “taxable year” means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the taxable income is computed under subtitle A. “Taxable year” means, in the case of a return made for a fractional part of a year under the provisions of subtitle A or under regulations prescribed by the Secretary, the period for which such return is made.

(24) **Fiscal year.**— The term “fiscal year” means an accounting period of 12 months ending on the last day of any month other than December.

(25) **Paid or incurred, paid or accrued.**— The terms “paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which the taxable income is computed under subtitle A.

(26) **Trade or business.**— The term “trade or business” includes the performance of the functions of a public office.

(30) **United States person.**— The term “United States person” means—

(A) a citizen or resident of the United States,

(B) a domestic partnership,

(C) a domestic corporation,

(D) any estate (other than a foreign estate, within the meaning, of paragraph (31)), and

(E) any trust if—

(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and

(ii) one or more United States persons have the authority to control all substantial decisions of the trust.

(31) **Foreign estate or trust.**—

(A) **Foreign estate.**— The term “foreign estate” means an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A.

(B) **Foreign trust.**— The term “foreign trust” means any trust other than a foreign estate, within the meaning of paragraph (31).

(38) **Joint return.**— The term “joint return” means a single return made jointly under section 6013 by a husband and wife.

(39) **Persons residing outside United States.**— If any citizen or resident of the United States does not reside in (and is not found in) any United States judicial district, such citizen or resident shall be treated as residing in the District of Columbia for purposes of any provision of this title relating to—

(A) jurisdiction of courts, or

(B) enforcement of summons.

[§ 7701(b)—Definition of Resident]

(1) **In general.**— For purposes of this title (other than subtitle B)—

(A) **Resident alien.**— An alien individual shall be treated as a resident of the United States with respect to any calendar year if (and only if) such individual meets the requirements of clause (i), (ii), or (iii):

(i) **Lawfully admitted for permanent residence.**— Such individual is a lawful permanent resident of the United States at any time during such calendar year.

(ii) **Substantial presence test.**— Such individual meets the substantial presence test of paragraph (3).

(iii) **First year election.**— Such individual makes the election provided in paragraph (4).

(B) **Nonresident alien.**— An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States (within the meaning of subparagraph (A)).

(2) **Special rules for first and last year of residency.**—

(A) **First year of residency.**—

(i) **In general.**— If an alien individual is a resident of the United States under paragraph (1)(A) with respect to any calendar year, but was not a resident of the United States at any time during the preceding calendar year, such alien individual shall be treated as a resident of the United States only for the portion of such calendar year which begins on the residency starting date.

(ii) **Residency starting date for individuals lawfully admitted for permanent residence.**— In the case of an individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test of paragraph (3), the residency starting date shall be the first day in such calendar year on
which he was present in the United States while a lawful permanent resident of the United States.

(iii) **Residency starting date for individuals meeting substantial presence test.**— In the case of an individual who meets the substantial presence test of paragraph (3) with respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

(iv) **Residency starting date for individuals making first year election.**— In the case of an individual who makes the election provided by paragraph (4) with respect to any calendar year, the residency starting date shall be the 1st day during such calendar year on which the individual is treated as a resident of the United States under that paragraph.

(B) **Last year of residency.**— An alien individual shall not be treated as a resident of the United States during a portion of any calendar year if—

(i) such portion is after the last day in such calendar year on which the individual was present in the United States (or, in the case of an individual described in paragraph (1)(A)(i), the last day on which he was so described),

(ii) during such portion the individual has a closer connection to a foreign country than to the United States, and

(iii) the individual is not a resident of the United States at any time during the next calendar year.

(C) **Certain nominal presence disregarded.**—

(i) In general.— For purposes of subparagraphs (A)(iii) and (B), an individual shall not be treated as present in the United States during any period for which the individual establishes that he has a closer connection to a foreign country than to the United States.

(ii) Not more than 10 days disregarded.— Clause (i) shall not apply to more than 10 days on which the individual is present in the United States.

(3) **Substantial presence test.**—

(A) In general.— Except as otherwise provided in this paragraph, an individual meets the substantial presence test of this paragraph with respect to any calendar year (hereinafter in this subsection referred to as the “current year”) if—

(i) such individual was present in the United States on at least 31 days during the calendar year, and

(ii) the sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days:

<table>
<thead>
<tr>
<th>In the case of days in:</th>
<th>The applicable multiplier is:</th>
</tr>
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<tbody>
<tr>
<td>Current year</td>
<td>1</td>
</tr>
<tr>
<td>1st preceding year</td>
<td>1/3</td>
</tr>
<tr>
<td>2nd preceding year</td>
<td>1/6</td>
</tr>
</tbody>
</table>

(B) **Exception where individual is present in the United States during less than one-half of current year and closer connection to foreign country is established.**— An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current year if—

(i) such individual is present in the United States on fewer than 183 days during the current year, and

(ii) it is established that for the current year such individual has a tax home (as defined in section 911(d)(3) without regard to the second sentence thereof) in a foreign country and has a closer connection to such foreign country than to the United States.

(C) **Subparagraph (B) not to apply in certain cases.**— Subparagraph (B) shall not apply to any individual with respect to any current year if at any time during such year—

(i) such individual had an application for adjustment of status pending, or

(ii) such individual took other steps to apply for status as a lawful permanent resident of the United States.

(D) **Exception for exempt individuals or for certain medical conditions.**— An individual shall not be treated as being present in the United States during any day if—

(i) such individual is an exempt individual for such day, or

(ii) such individual was unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States.

(4) **First-year election.**—

(A) An alien individual shall be deemed to meet the requirements of this subparagraph if such individual—

(i) is not a resident of the United States under clause (i) or (ii) of paragraph (1)(A) with respect to a calendar year (hereinafter referred to as the “election year”),

(ii) was not a resident of the United States under paragraph (1)(A) with respect to the calendar year immediately preceding the election year,
(iii) is a resident of the United States under clause (ii) of paragraph (1)(A) with respect to the calendar year immediately following the election year, and

(iv) is both—

(I) present in the United States for a period of at least 31 consecutive days in the election year, and

(II) present in the United States during the period beginning with the first day of such 31-day period and ending with the last day of the election year (hereinafter referred to as the “testing period”) for a number of days equal to or exceeding 75 percent of the number of days in the testing period (provided that an individual shall be treated for purposes of this subclause as present in the United States for a number of days during the testing period not exceeding 5 days in the aggregate, notwithstanding his absence from the United States on such days).

(B) An alien individual who meets the requirements of subparagraph (A) shall, if he so elects, be treated as a resident of the United States with respect to the election year.

(C) An alien individual who makes the election provided by subparagraph (B) shall be treated as a resident of the United States for the portion of the election year which begins on the 1st day of the earliest testing period during such year with respect to which the individual meets the requirements of clause (iv) of subparagraph (A).

(D) The rules of subparagraph (D)(i) of paragraph (3) shall apply for purposes of determining an individual’s presence in the United States under this paragraph.

(E) An election under subparagraph (B) shall be made on the individual’s tax return for the election year, provided that such election may not be made before the individual has met the substantial presence test of paragraph (3) with respect to the calendar year immediately following the election year.

(F) An election once made under subparagraph (B) remains in effect for the election year, unless revoked with the consent of the Secretary.

(5) Exempt individual defined.—For purposes of this subsection—

(A) In general.—An individual is an exempt individual for any day if, for such day, such individual is—

(i) a foreign government-related individual,

(ii) a teacher or trainee,

(iii) a student, or

(iv) a professional athlete who is temporarily in the United States to compete in a charitable sports event described in section 274(l)(1)(B).

(B) Foreign government-related individual.—The term “foreign government-related individual” means any individual temporarily present in the United States by reason of—

(i) diplomatic status, or a visa which the Secretary (after consultation with the Secretary of State) determines represents full-time diplomatic or consular status for purposes of this subsection,

(ii) being a full-time employee of an international organization, or

(iii) being a member of the immediate family of an individual described in clause (i) or (ii).

(C) Teacher or trainee.—The term “teacher or trainee” means any individual—

(i) who is temporarily present in the United States under subparagraph (I) or (Q) of section 101(15) of the Immigration and Nationality Act (other than as a student), and

(ii) who substantially complies with the requirements for being so present.

(D) Student.—The term “student” means any individual—

(i) who is temporarily present in the United States—

(I) under subparagraph (F) or (M) of section 101(15) of the Immigration and Nationality Act, or

(II) as a student under subparagraph (J) of such section 101(15), and

(ii) who substantially complies with the requirements for being so present.

(E) Special rules for teachers, trainees, and students.—

(i) Limitation on teachers and trainees.—An individual shall not be treated as an exempt individual by reason of clause (ii) of subparagraph (A) for the current year if, for any 2 calendar years during the preceding 6 calendar years, such person was an exempt person under clause (ii) or (iii) of subparagraph (A). In the case of an individual all of whose compensation is described in section 872(b)(3), the preceding sentence shall be applied by substituting “4 calendar years” for “2 calendar years”.

(ii) Limitation on students.—For any calendar year after the 5th calendar year for which an individual was an exempt individual under clause (ii) or (iii) of subparagraph (A), such individual shall not be treated as an exempt individual by reason of clause (iii) of subparagraph (A), unless such individual establishes to the satisfaction of the Secretary that such individual does not intend to permanently reside in the United States.
and that such individual meets the requirements of sub-
paragraph (D)(ii).

(6) Lawful permanent resident.– For purposes of this
subsection, an individual is a lawful permanent resident of the
United States at any time if—

(A) such individual has the status of having been
lawfully accorded the privilege of residing permanently in
the United States as an immigrant in accordance with the
immigration laws, and

(B) such status has not been revoked (and has not been
administratively or judicially determined to have been
abandoned).

An individual shall cease to be treated as a lawful permanent
resident of the United States if such individual commences to
be treated as a resident of a foreign country under the
provisions of a tax treaty between the United States and the
foreign country, does not waive the benefits of such treaty
applicable to residents of the foreign country, and notifies the
Secretary of the commencement of such treatment.

(7) Presence in the United States.– For purposes of this
subsection—

(A) In general.– Except as provided in subparagraph
(B), (C), or (D), an individual shall be treated as present in
the United States on any day if such individual is physically
present in the United States at any time during such day.

(B) Commuters from Canada or Mexico.– If an indi-
vidual regularly commutes to employment (or self-employ-
ment) in the United States from a place of residence in
Canada or Mexico, such individual shall not be treated as
present in the United States on any day during which he so
commutes.

(C) Transit between 2 foreign points.– If an
individual, who is in transit between 2 points outside the
United States, is physically present in the United States for
less than 24 hours, such individual shall not be treated as
present in the United States on any day during such transit.

(D) Crew members temporarily present.– An
individual who is temporarily present in the United States
on any day as a regular member of the crew of a foreign
vessel engaged in transportation between the United States
and a foreign country or a possession of the United States
shall not be treated as present in the United States on such
day unless such individual otherwise engages in any trade
or business in the United States on such day.

(8) Annual statements.– The Secretary may prescribe
regulations under which an individual who (but for subpara-
graph (B) or (D) of paragraph (3)) would meet the substantial
presence test of paragraph (3) is required to submit an annual
statement setting forth the basis on which such individual
claims the benefits of subparagraph (B) or (D) of paragraph
(3), as the case may be.

(9) Taxable year.–

(A) In general.– For purposes of this title, an alien
individual who has not established a taxable year for any
prior period shall be treated as having a taxable year which
is the calendar year.

(B) Fiscal year taxpayer.– If—

(i) an individual is treated under paragraph (1) as a
resident of the United States for any calendar year, and

(ii) after the application of subparagraph (A), such
individual has a taxable year other than a calendar year,

he shall be treated as a resident of the United States with
respect to any portion of a taxable year which is within
such calendar year.

(10) Coordination with section 877.– If—

(A) an alien individual was treated as a resident of
the United States during any period which includes at least 3
consecutive calendar years (hereinafter referred to as the
“initial residency period”), and

(B) such individual ceases to be treated as a resident of
the United States but subsequently becomes a resident of
the United States before the close of the 3rd calendar year
beginning after the close of the initial residency period,

such individual shall be taxable for the period after the close
of the initial residency period and before the day on which he
subsequently became a resident of the United States in the
manner provided in section 877(b). The preceding sentence
shall apply only if the tax imposed pursuant to section 877(b)
exceeds the tax which, without regard to this paragraph, is
imposed pursuant to section 871.

(11) Regulations.– The Secretary shall prescribe such
regulations as may be necessary or appropriate to carry out
the purposes of this subsection.

[
§ 7701(c)—“Includes” Not Exclusive
]

(c) Includes and Including.– The terms “includes” and
“including” when used in a definition contained in this title shall
not be deemed to exclude other things otherwise within the
meaning of the term defined.

[
§ 7701(d)—Puerto Rico a “Possession”
]

(d) Commonwealth of Puerto Rico.– Where not otherwise
distinctly expressed or manifestly incompatible with the intent
thereof, references in this title to possessions of the United
States shall be treated as also referring to the Commonwealth of
Puerto Rico.
§ 7701 (f)—Anti-Avoidance Regs.

(f) Use of related persons or pass-thru entities.—The Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of those provisions of this title which deal with—

1. the linking of borrowing to investment, or
2. diminishing risks, through the use of related persons, pass-thru entities, or other intermediaries.

§ 7701 (l)—Anti-Conduit Rules

(l) Regulations Relating to Conduit Arrangements.—The Secretary may prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by this title.

Section 7852.
Other Applicable Rules

(a) Separability Clause.—If any provision of this title, or the application thereof to any person or circumstances, is held invalid, the remainder of the title, and the application of such provision to other persons or circumstances, shall not be affected thereby.

(b) Reference in Other Laws to Internal Revenue Code of 1939.—Any reference in any other law of the United States or in any Executive order to any provision of the Internal Revenue Code of 1939 shall, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, be deemed also to refer to the corresponding provision of this title.

(c) Items Not to Be Twice Included in Income or Deducted Therefrom.—Except as otherwise distinctly expressed or manifestly intended, the same item (whether of income, deduction, credit, or otherwise) shall not be taken into account both in computing a tax under subtitle A of this title and a tax under chapter 1 or 2 of the Internal Revenue Code of 1939.

(d) Treaty Obligations.—

(1) In general.—For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law.

(2) Savings clause for 1954 treaties.—No provision of this title (as in effect without regard to any amendment thereto enacted after August 16, 1954) shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on August 16, 1954.

(3) Privacy Act of 1974.—The provisions of subsections (d)(2), (3), and (4), and (g) of section 552a of title 5, United States Code, shall not be applied, directly or indirectly, to the determination of the existence or possible existence of liability (or the amount thereof) of any person for any tax, penalty, interest, fine, forfeiture, or other imposition or offense to which the provisions of this title apply.

Section 7874.
Rules Relating to Expatriated Entities and Their Foreign Parents

(a) Tax on inversion gain of expatriated entities.—

(1) In general.—The taxable income of an expatriated entity for any taxable year which includes any portion of the applicable period shall in no event be less than the inversion gain of the entity for the taxable year.

(2) Expatriated entity.—For purposes of this subsection—

(A) In general.—The term “expatriated entity” means—

(i) the domestic corporation or partnership referred to in subparagraph (B)(i) with respect to which a foreign corporation is a surrogate foreign corporation, and

(ii) any United States person who is related (within the meaning of section 267(b) or 707(b)(1)) to a domestic corporation or partnership described in clause (i).

(B) Surrogate foreign corporation.—A foreign corporation shall be treated as a surrogate foreign corporation if, pursuant to a plan (or a series of related transactions)

(i) the entity completes after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership,
(ii) after the acquisition at least 60 percent of the stock (by vote or value) of the entity is held—

(I) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or

(II) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership, and

(iii) after the acquisition the expanded affiliated group which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity is created or organized, when compared to the total business activities of such expanded affiliated group.

An entity otherwise described in clause (i) with respect to any domestic corporation or partnership trade or business shall be treated as not so described if, on or before March 4, 2003, such entity acquired directly or indirectly more than half of the properties held directly or indirectly by such corporation or more than half of the properties constituting such partnership trade or business, as the case may be.

(3) Coordination with subsection (b).—A corporation which is treated as a domestic corporation under subsection (b) shall not be treated as a surrogate foreign corporation for purposes of paragraph (2)(A).

(b) Inverted corporations treated as domestic corporations.—Notwithstanding section 7701(a)(4), a foreign corporation shall be treated for purposes of this title as a domestic corporation if such corporation would be a surrogate foreign corporation if subsection (a)(2) were applied by substituting “80 percent” for “60 percent”.

(c) Definitions and special rules.—

(1) Expanded affiliated group.—The term “expanded affiliated group” means an affiliated group as defined in section 1504(a) but without regard to section 1504(b)(3), except that section 1504(a) shall be applied by substituting “more than 50 percent” for “at least 80 percent” each place it appears.

(2) Certain stock disregarded.—There shall not be taken into account in determining ownership under subsection (a)(2)(B)(ii)—

(A) stock held by members of the expanded affiliated group which includes the foreign corporation, or

(B) stock of such foreign corporation which is sold in a public offering related to the acquisition described in subsection (a)(2)(B)(i).

(3) Plan deemed in certain cases.—If a foreign corporation acquires directly or indirectly substantially all of the properties of a domestic corporation or partnership during the 4-year period beginning on the date which is 2 years before the ownership requirements of subsection (a)(2)(B)(ii) are met, such actions shall be treated as pursuant to a plan.

(4) Certain transfers disregarded.—The transfer of properties or liabilities (including by contribution or distribution) shall be disregarded if such transfers are part of a plan a principal purpose of which is to avoid the purposes of this section.

(5) Special rule for related partnerships.—For purposes of applying subsection (a)(2)(B)(ii) to the acquisition of a trade or business of a domestic partnership, except as provided in regulations, all partnerships which are under common control (within the meaning of section 482) shall be treated as 1 partnership.

(6) Regulations.—The Secretary shall prescribe such regulations as may be appropriate to determine whether a corporation is a surrogate foreign corporation, including regulations—

(A) to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and

(B) to treat stock as not stock.

(d) Other definitions.—For purposes of this section—

(1) Applicable period.—The term “applicable period” means the period—

(A) beginning on the first date properties are acquired as part of the acquisition described in subsection (a)(2)(B)(i), and

(B) ending on the date which is 10 years after the last date properties are acquired as part of such acquisition.

(2) Inversion gain.—The term “inversion gain” means the income or gain recognized by reason of the transfer during the applicable period of stock or other properties by an expatriated entity, and any income received or accrued during the applicable period by reason of a license of any property by an expatriated entity—

(A) as part of the acquisition described in subsection (a)(2)(B)(i), or

(B) after such acquisition if the transfer or license is to a foreign related person. Subparagraph (B) shall not apply to property described in section 1221(a)(1) in the hands of the expatriated entity.
(3) Foreign related person.—The term “foreign related person” means, with respect to any expatriated entity, a foreign person which—

(A) is related (within the meaning of section 267(b) or 707(b)(1)) to such entity, or

(B) is under the same common control (within the meaning of section 482) as such entity.

c) Special rules.—

(1) Credits not allowed against tax on inversion gain.—Credits (other than the credit allowed by section 901) shall be allowed against the tax imposed by this chapter on an expatriated entity for any taxable year described in subsection (a) only to the extent such tax exceeds the product of—

(A) the amount of the inversion gain for the taxable year, and

(B) the highest rate of tax specified in section 11(b)(1).

For purposes of determining the credit allowed by section 901, inversion gain shall be treated as from sources within the United States.

(2) Special rules for partnerships.—In the case of an expatriated entity which is a partnership—

(A) subsection (a)(1) shall apply at the partner rather than the partnership level,

(B) the inversion gain of any partner for any taxable year shall be equal to the sum of—

(i) the partner’s distributive share of inversion gain of the partnership for such taxable year, plus

(ii) gain recognized for the taxable year by the partner by reason of the transfer during the applicable period of any partnership interest of the partner in such partnership to the surrogate foreign corporation, and

(C) the highest rate of tax specified in the rate schedule applicable to the partner under this chapter shall be substituted for the rate of tax referred to in paragraph (1).

(3) Coordination with section 172 and minimum tax.—Rules similar to the rules of paragraphs (3) and (4) of section 860E(a) shall apply for purposes of subsection (a).

(4) Statute of limitations.—

(A) In general.—The statutory period for the assessment of any deficiency attributable to the inversion gain of any taxpayer for any pre-inversion year shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of the acquisition described in subsection (a)(2)(B)(i) to which such gain relates and such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(B) Pre-inversion year.—For purposes of subparagraph (A), the term “pre-inversion year” means any taxable year if—

(i) any portion of the applicable period is included in such taxable year, and

(ii) such year ends before the taxable year in which the acquisition described in subsection (a)(2)(B)(i) is completed.

(f) Special rule for treaties.—Nothing in section 894 or 7852(d) or in any other provision of law shall be construed as permitting an exemption, by reason of any treaty obligation of the United States heretofore or hereafter entered into, from the provisions of this section.

g) Regulations.—The Secretary shall provide such regulations as are necessary to carry out this section, including regulations providing for such adjustments to the application of this section as are necessary to prevent the avoidance of the purposes of this section, including the avoidance of such purposes through—

(1) the use of related persons, pass-through or other noncorporate entities, or other intermediaries, or

(2) transactions designed to have persons cease to be (or not become) members of expanded affiliated groups or related persons.