

*Example 1.* (i) A is a U.S. citizen who resides in State R. The Federal Individual Income Tax Return, Form 1040, that A prepares for 2004 reports adjusted gross income of \$90x, including \$30x from sources in the U.S. Virgin Islands (USVI). The income tax liability reported on A's Form 1040 is \$18x. A files a copy of his Federal Form 1040 with the USVI Bureau of Internal Revenue as required by section 932(a)(2) and paragraph (b)(1) of this section, and pays the applicable percentage of his Federal income tax liability to the USVI as required by section 932(b) and paragraph (b)(2) of this section, computed as follows:

$30/90 \times 18x = \$6x$  income tax liability to the USVI

(ii) A claims a credit against his Federal income tax liability reported on his Form 1040 in the amount of \$6x. A attaches a Form 8689, "Allocation of Individual Income Tax to the Virgin Islands," to the Form 1040 filed with the Internal Revenue Service and to the copy of the Form 1040 filed with the USVI.

*Example 2.* [Reserved]

*Example 3.* H and W are U.S. citizens. H resides in State T and W is a bona fide resident of the U.S. Virgin Islands (USVI). For 2004, H and W prepare a joint Individual Income Tax Return, Form 1040, which reports total adjusted gross income of \$75x of which \$40x is attributable to compensation that W received for services performed in the USVI and \$35x to compensation that H received for services performed in State T. Pursuant to section 932(d) and paragraph (d) of this section, the joint income tax return of H and W is filed with the USVI as required by section 932(c) and paragraph (c) of this section. H and W may claim a tax credit on such return for income tax withheld during 2004 and paid to the Internal Revenue Service.

*Example 4.* (i) The facts are the same as in example 3, except that H also earns \$25x for services performed in the USVI, so that H and W's total adjusted gross income is \$100x, and their total income tax liability is \$20x.

(ii) Pursuant to section 932(d) and paragraph (d) of this section, H and W must file a copy of their joint Federal Form 1040 with the Bureau of Internal Revenue of the USVI as required by section 932(a)(2) and paragraph (b)(1) of this section, and pay the applicable percentage of their Federal income tax liability to the USVI as required by section 932(b) and paragraph (b)(2) of this section, computed as follows:

$65/100 \times 20x = \$13x$  income tax liability to the USVI

(iii) H and W claim a credit against their Federal income tax liability reported on the Form 1040 in the amount of \$13x, the portion of their Federal income tax liability required to be paid to the USVI. H and W attach a Form 8689, "Allocation of Individual Income

Tax to the Virgin Islands," to the Form 1040 filed with the Internal Revenue Service and to the copy of the Form 1040 filed with the USVI.

*Example 5.* J is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands (USVI). In 2005, J receives compensation for services performed in the USVI in the amount of \$40x. J prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports gross income of only \$30x. J has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes and, therefore, must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

*Example 6.* (i) N is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands. In 2004, N receives compensation for services performed in Country M. N prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports the compensation as income effectively connected with the conduct of a trade or business in the USVI. N claims a special credit against the tax on this compensation purportedly pursuant to a USVI law enacted within the limits of its authority under section 934.

(ii) Under the principles of section 864(c)(4) as applied pursuant to section 937(b)(1) and § 1.937-3T(b), compensation for services performed outside the USVI may not be treated as income effectively connected with the conduct of a trade or business in the USVI for purposes of section 934(b). Consequently, N is not entitled to claim the special credit under USVI law with respect to N's income from services performed in Country M. Given that N has not fully paid his tax liability referred to in section 934(a), he has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes. Accordingly, N must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

(j) *Effective date.* This section shall apply for taxable years ending after October 22, 2004.

[T.D. 9194, 70 FR 18931, Apr. 11, 2005, as amended by T.D. 9248, 71 FR 5001, Jan. 31, 2006]

#### § 1.933-1 Exclusion of certain income from sources within Puerto Rico.

(a) [Reserved]. For further guidance, see § 1.933-1T(a).

(b) *Taxable year of change of residence from Puerto Rico.* A citizen of the United States who changes his residence from Puerto Rico after having

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been a bona fide resident thereof for a period of at least two years immediately preceding the date of such change in residence shall exclude from his gross income the income derived from sources within Puerto Rico which is attributable to that part of such period of Puerto Rican residence which preceded the date of such change in residence, except amounts received for services performed as an employee of the United States or any agency thereof.

(c) [Reserved]. For further guidance, see § 1.933-1T(c).

(d) [Reserved]. For further guidance, see § 1.933-1T(d).

(e) [Reserved]. For further guidance, see § 1.933-1T(e).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 9194, 70 FR 18934, Apr. 11, 2005]

### § 1.933-1T Exclusion of certain income from sources within Puerto Rico (temporary).

(a) *General rule*—(1) An individual (whether a United States citizen or an alien), who is a bona fide resident of Puerto Rico during the entire taxable year, shall exclude from gross income the income derived from sources within Puerto Rico, except amounts received for services performed as an employee of the United States or any agency thereof.

(2) The following example illustrates the application of the general rule in paragraph (a)(1) of this section:

*Example.* [Reserved]

(b) [Reserved] For further guidance, see § 1.933-1(b).

(c) *Deductions and credits.* In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 933, there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions (except the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to, or chargeable against, the amounts so excluded from gross income. For purposes of the preceding sentence, the rules of § 1.861-8 shall apply (with creditable expenditures treated in the same manner as deductible expenditures).

(d) *Definitions.* For purposes of this section:

(1) The rules of § 1.937-1T shall apply for determining whether an individual is a bona fide resident of Puerto Rico.

(2) The rules of § 1.937-2T shall apply for determining whether income is from sources within Puerto Rico.

(e) *Effective date.* This section shall apply for taxable years ending after October 22, 2004.

[T.D. 9194, 70 FR 18934, Apr. 11, 2005, as amended by T.D. 9248, 71 FR 5001, Jan. 31, 2006]

### § 1.934-1 Limitation on reduction in income tax liability incurred to the Virgin Islands.

[Reserved]. For further guidance, see § 1.934-1T.

[T.D. 9194, 70 FR 18935, Apr. 11, 2005]

### § 1.934-1T Limitation on reduction in income tax liability incurred to the Virgin Islands (temporary).

(a) *General rule.* Section 934(a) provides that tax liability incurred to the United States Virgin Islands (Virgin Islands) shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in section 934(b). For purposes of the preceding sentence, the term “tax liability” means the liability incurred to the Virgin Islands pursuant to subtitle A of the Internal Revenue Code, as made applicable in the Virgin Islands by the Act of July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642), as modified by section 7651(5)(B).

(b) *Exception for V.I. income*—(1) *In general.* Section 934(b)(1) provides an exception to the application of section 934(a). Under this exception, section 934(a) does not apply with respect to tax liability incurred to the Virgin Islands to the extent that such tax liability is attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands.

(2) *Limitation.* Section 934(b)(2) limits the scope of the exception provided by