

in year 2, because the section 481(a) adjustment resulting from the change in method of accounting for deferring advance payments under the contract is zero, and because Corp A is not required to change from its method of accounting for the cost of developing the computer program and updates under the contract as a result of the election.

Example 3. Assume the same facts as in *Example 1* except that Corp A is entitled to receive payments for the computer program and each of the updates 30 days after delivery. Corp A properly includes the amounts due under the contract in gross income in the taxable year the computer program or updates are provided. Assume that Corp A properly uses the nonaccrual-experience method described in section 448(d)(5) and § 1.448-2T to account for income on its contracts. If Corp A made an election under paragraph (i)(2)(ii) of this section, Corp A would be required to change from the nonaccrual-experience method for income as a result of the election, because the method is only available with respect to amounts to be received for the performance of services. Therefore, Corp A may not elect to apply the provisions of this section to the updates provided in years 3, 4, and 5, under paragraph (i)(2)(ii) of this section, because Corp A would be required to change from the nonaccrual-experience method of accounting for income on the contract as a result of the election.

(j) *Change in method of accounting required by this section—(1) Consent.* A taxpayer is granted consent to change its method of accounting for contracts involving computer programs, to conform with the classification prescribed in this section. The consent is granted for contracts entered into on or after December 1, 1998, or in the case of a taxpayer making an election under paragraph (i)(2)(i) of this section, the consent is granted for contracts entered into in taxable years ending on or after October 2, 1998. In addition, a taxpayer that makes an election under paragraph (i)(2)(ii) of this section is granted consent to change its method of accounting for any contract with transactions subject to the election, if the taxpayer is required to change its method of accounting as a result of the election.

(2) *Year of change.* The year of change is the taxable year that includes December 1, 1998, or in the case of a taxpayer making an election under paragraph (i)(2)(i) or (i)(2)(ii) of this section, the taxable year that includes October 2, 1998.

(k) *Time and manner of making change in method of accounting—(1) General.* A taxpayer changing its method of accounting in accordance with this section must file a Form 3115, Application for Change in Method of Accounting, in duplicate. The taxpayer must type or print the following statement at the top of page 1 of the Form 3115: “FILED UNDER TREASURY REGULATION § 1.861-18.” The original Form 3115 must be attached to the taxpayers original return for the year of change. A copy of the Form 3115 must be filed with the National Office no later than when the original Form 3115 is filed for the year of change.

(2) *Copy of Form 3115.* The copy required by this paragraph (k)(1) to be sent to the national office should be sent to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, P.O. Box 7604, Benjamin Franklin Station, Washington DC 20044 (or in the case of a designated private delivery service: Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW., Washington, DC 20224).

(3) *Effect of consent and Internal Revenue Service review.* A change in method of accounting granted under this section is subject to review by the district director and the national office and may be modified or revoked in accordance with the provisions of Rev. Proc. 97-37 (1997-33 IRB 18) (or its successors) (see § 601.601(d)(2) of this chapter).

[T.D. 8785, 63 FR 52977, Oct. 2, 1998; 63 FR 64868, Nov. 24, 1998]

§ 1.862-1 Income specifically from sources without the United States.

(a) *Gross income.* (1) The following items of gross income shall be treated as income from sources without the United States:

(i) Interest other than that specified in section 861(a)(1) and § 1.861-2 as being derived from sources within the United States;

(ii) Dividends other than those derived from sources within the United States as provided in section 861(a)(2) and § 1.861-3;

(iii) Compensation for labor or personal services performed without the United States;

(iv) 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, goodwill, trademarks, trade brands, franchises, and other like property;

(v) Gains, profits, and income from the sale of real property located without the United States; and

(vi) Gains, profits, and income derived from the purchase of personal property within the United States and its sale without the United States.

(2) In applying subparagraph (1)(iv) of this paragraph for taxable years beginning after December 31, 1966, gains described in section 871(a)(1)(D) and section 881(a)(4) from the sale or exchange after October 4, 1966, of patents, copyrights, and other like property shall be treated, as provided in section 871(e)(2), as rentals or royalties for the use of, or privilege of using, property or an interest in property. See paragraph (e) of § 1.871-11.

(3) For determining the time and place of sale of personal property for purposes of subparagraph (1)(vi) of this paragraph, see paragraph (c) of § 1.861-7.

(4) Income derived from the purchase of personal property within the United States and its sale within a possession of the United States shall be treated as derived entirely from within that possession.

(5) If interest is paid on an obligation of a nonresident of the United States by a resident of the United States acting in the resident's capacity as a guarantor of the obligation of the nonresident, the interest will be treated as income from sources without the United States.

(6) For rules treating certain interest as income from sources without the United States, see paragraph (b) of § 1.861-2.

(7) For the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States, see paragraph (b) of § 1.861-4.

(b) *Taxable income.* The taxable income from sources without the United States, in the case of the items of gross

income specified in paragraph (a) of this section, shall be determined on the same basis as that used in § 1.861-8 for determining the taxable income from sources within the United States.

(c) *Income from certain property.* For provisions permitting a taxpayer to elect to treat amounts of gross income attributable to certain aircraft or vessels first leased on or before December 28, 1980, as income from sources within the United States which would otherwise be treated as income from sources without the United States under paragraph (a) of this section, see § 1.861-9. For provisions requiring amounts of gross income attributable to certain aircraft, vessels, or spacecraft first leased by the taxpayer after December 28, 1980, to be treated as income from sources within the United States which would otherwise be treated as income from sources without the United States under paragraph (a) of this section, see § 1.861-9A.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7378, 40 FR 45434, Oct. 2, 1975; 40 FR 48508, Oct. 16, 1975; T.D. 7928, 48 FR 55847, Dec. 16, 1983]

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This section lists captions contained in §§ 1.863-1, 1.863-2, and 1.863-3.

§ 1.863-1 Allocation of gross income under section 863(a).

- (a) In general.
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- (e) Residual interest in a REMIC.
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§ 1.863-2 Allocation and apportionment of taxable income.

- (a) Determination of taxable income.
- (b) Determination of source of taxable income.