

by paragraphs (b) to (f), inclusive, of this section.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 8687, 61 FR 60550, Nov. 29, 1996]

**§ 1.863-6 Income from sources within a foreign country.**

The principles applied in sections 861 through 863 and section 865 and the regulations thereunder for determining the gross and the taxable income from sources within and without the United States shall generally be applied in determining the gross and the taxable income from sources within and without a particular foreign country when such a determination must be made under any provision of Subtitle A of the Internal Revenue Code, including section 952(a)(5). This section shall not apply, however, to the extent it is determined by applying § 1.863-3 that a portion of the taxable income is from sources within the United States and the balance of the taxable income is from sources within a foreign country. In the application of this section, the name of the particular foreign country shall be used instead of the term *United States*, and the term *domestic* shall be construed to mean created or organized in such foreign country. In applying section 861 and the regulations thereunder for purposes of this section, references to sections 243 and 245 shall be excluded, and the exception in section 861(a)(3) shall not apply. In the case of any item of income, the income from sources within a foreign country shall not exceed the amount which, by applying any provision of sections 861 through 863 and section 865 and the regulations thereunder without reference to this section, is treated as income from sources without the United States. See § 1.937-2T for rules for determining income from sources within a possession of the United States.

[T.D. 9194, 70 FR 18928, Apr. 11, 2005]

**§ 1.863-7 Allocation of income attributable to certain notional principal contracts under section 863(a).**

(a) *Scope*—(1) *Introduction*. This section provides rules relating to the source and, in certain cases, the character of notional principal contract income. However, this section does not

apply to income from a section 988 transaction within the meaning of section 988 and the regulations thereunder, relating to the treatment of certain nonfunctional currency transactions. Notional principal contract income is income attributable to a notional principal contract. A notional principal contract is a financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts. An agreement between a taxpayer and a qualified business unit (as defined in section 989(a)) of the taxpayer, or among qualified business units of the same taxpayer, is not a notional principal contract, because a taxpayer cannot enter into a contract with itself.

(2) *Effective date*. This section applies to notional principal contract income includible in income on or after February 13, 1991. However, any taxpayer desiring to apply paragraph (b)(2)(iv) of this section to notional principal contract income includible in income prior to February 13, 1991, in lieu of temporary Income Tax Regulations § 1.863-7T(b)(2)(iv) may (on a consistent basis) so choose. See paragraph (c) of this section for an election to apply the rules of this section to notional principal contract income includible in income before December 24, 1986.

(b) *Source of notional principal contract income*—(1) *General rule*. Unless paragraph (b) (2) or (3) of this section applies, the source of notional principal contract income shall be determined by reference to the residence of the taxpayer as determined under section 988(a)(3)(B)(i).

(2) *Qualified business unit exception*. The source of notional principal contract income shall be determined by reference to the residence of a qualified business unit of a taxpayer if—

(i) The taxpayer's residence, determined under section 988(a)(3)(B)(i), is the United States;

(ii) The qualified business unit's residence, determined under section 988(a)(3)(B)(ii), is outside the United States;