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United States during the taxable year through the effecting of such transactions, nevertheless he shall be required to include in gross income for the taxable year the gains and profits from those transactions to the extent required by § 1.871-7 or § 1.871-8.

(3) *Exclusions.* For exclusions from gross income, see § 1.872-2.

(b) *Individuals not engaged in U.S. business.* In the case of a nonresident alien individual who at no time during the taxable year is engaged in trade or business in the United States, the gross income shall include only (1) the gross income from sources within the United States which is described in section 871(a) and paragraphs (b), (c), and (d) of § 1.871-7, and (2) the gross income from sources within the United States which, by reason of section 871 (c) or (d) and § 1.871-9 or § 1.871-10, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by that individual.

(c) *Individuals engaged in U.S. business.* In the case of a nonresident alien individual who is engaged in trade or business in the United States at any time during the taxable year, the gross income shall include (1) the gross income from sources within and without the United States which is effectively connected for the taxable year with the conduct of a trade or business in the United States by that individual, (2) the gross income from sources within the United States which, by reason of the election provided in section 871(d) and § 1.871-10, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by that individual, and (3) the gross income from sources within the United States which is described in section 871(a) and paragraphs (b), (c), and (d) of § 1.871-7 and is not effectively connected for the taxable year with the conduct of a trade or business in the United States by that individual.

(d) *Special rules applicable to certain expatriates.* For special rules for determining the gross income of a nonresident alien individual who has lost U.S. citizenship with a principal purpose of avoiding certain taxes, see section 877(b)(1).

(e) *Alien resident of Puerto Rico.* This section shall not apply in the case of a nonresident alien individual who is a bona fide resident of Puerto Rico during the entire taxable year. See section 876 and § 1.876-1.

(f) *Effective date.* This section shall apply for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.872-1 (Revised as of January 1, 1971).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 7332, 39 FR 44228, Dec. 23, 1974]

§ 1.872-2 Exclusions from gross income of nonresident alien individuals.

(a) *Earnings of foreign ships or aircraft—(1) Basic rule.* So much of the income from sources within the United States of a nonresident alien individual as consists of earnings derived from the operation of a ship or ships documented, or of aircraft registered, under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in that foreign country and to corporations organized in the United States shall not be included in gross income.

(2) *Equivalent exemption—(i) Ships.* A foreign country which either imposes no income tax, or, in imposing an income tax, exempts from taxation so much of the income of a citizen of the U.S. nonresident in that foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States is considered as granting an equivalent exemption for purposes of the exclusion from gross income of the earnings of a foreign ship or ships.

(ii) *Aircraft.* A foreign country which either imposes no income tax, or, in imposing an income tax, exempts from taxation so much of the income of a citizen of the U.S. nonresident in that foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of aircraft registered under the laws of the United States is considered as granting an equivalent exemption for purposes of the exclusion from

gross income of the earnings of foreign aircraft.

(3) *Definition of earnings.* For purposes of subparagraphs (1) and (2) of this paragraph, compensation for personal services performed by an individual aboard a ship or aircraft does not constitute earnings derived by such individual from the operation of ships or aircraft.

(b) *Compensation paid by foreign employer to participants in certain exchange or training programs—(1) Exclusion from income.* Compensation paid to a nonresident alien individual for the period that the nonresident alien individual is temporarily present in the United States as a nonimmigrant under subparagraph (F) (relating to the admission of students into the United States) or subparagraph (J) (relating to the admission of teachers, trainees, specialists, etc., into the United States) of section 101(a)(15) of the Immigration and Nationality Act (8 U.S.C. 1101(a)(15) (F) or (J)) shall be excluded from gross income if the compensation is paid to such alien by his foreign employer. Compensation paid to a nonresident alien individual by the U.S. office of a domestic bank which is acting as paymaster on behalf of a foreign employer constitutes compensation paid by a foreign employer for purposes of this paragraph if the domestic bank is reimbursed by the foreign employer for such payment. A nonresident alien individual who is temporarily present in the United States as a nonimmigrant under such subparagraph (J) includes a nonresident alien individual admitted to the United States as an “exchange visitor” under section 201 of the U.S. Information and Educational Exchange Act of 1948 (22 U.S.C. 1446), which section was repealed by section 111 of the Mutual Education and Cultural Exchange Act of 1961 (75 Stat. 538).

(2) *Definition of foreign employer.* For purposes of this paragraph, the term “foreign employer” means a nonresident alien individual, a foreign partnership, a foreign corporation, or 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.

The term does not include a foreign government. However, see section 893 and §1.893-1. Thus, if a French citizen employed in the Paris branch of a banking company incorporated in the State of New York were admitted to the United States under section 101(a)(15)(J) of the Immigration and Nationality Act to study monetary theory and continued to receive a salary from such foreign branch while studying in the United States, such salary would not be includable in his gross income.

(c) *Tax convention.* Income of any kind which is exempt from tax under the provisions of a tax convention or treaty to which the United States is a party shall not be included in the gross income of a nonresident alien individual. Income on which the tax is limited by tax convention shall be included in the gross income of a nonresident alien individual if it is not otherwise excluded from gross income. See §§1.871-12 and 1.894-1.

(d) *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 U.S. savings bond shall not be included in gross income if such individual acquired the bond while he was a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands. It is not necessary that the individual continue to be a resident of such Islands or Trust Territory for the period when, without regard to section 872(b)(4) and this paragraph, the income from the bond would otherwise be includable in his gross income under the provisions of section 446 or 454.

(e) *Certain annuities received under qualified plans.* Pursuant to section 871(f), income received by a nonresident alien individual as an annuity under a qualified annuity plan described in section 403(a)(1) (relating to taxation of employee annuities), or from a qualified trust described in section 401(a) (relating to qualified pension, profit-sharing, and stock bonus plans) which is exempt from tax under section 501(a) (relating to exemption from tax on corporations, certain trusts, etc.), shall not be included in gross income, and shall be exempt from

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tax, for purposes of section 871 and §§ 1.871-7 and 1.871-8, if—

(1) All of the personal services by reason of which the annuity is payable were either—

(i) Personal services performed outside the United States by an individual (whether or not the annuitant) who, at the time of performance of the services, was a nonresident alien individual, or

(ii) Personal services performed in the United States by a nonresident alien individual (whether or not the annuitant) which, by reason of section 864(b)(1) (or corresponding provision of any prior law), were not personal services causing such individual to be engaged in trade or business in the United States during the taxable year, and

(2) At the time the first amount is paid (even though paid in a taxable year beginning before January 1, 1967) as such annuity under such annuity plan, or by such trust, to (i) the individual described in subparagraph (1) of this paragraph, or (ii) his nonresident alien beneficiary if such beneficiary is entitled to receive such first amount, 90 percent or more of the employees or annuitants for whom contributions or benefits are provided under the annuity plan, or under the plan or plans of which the trust is a part, are citizens or residents of the United States.

This paragraph shall apply whether or not the taxpayer is engaged in trade or business in the United States at any time during the taxable year in which the annuity is received. This paragraph shall not apply to distributions by an employees' trust or from an annuity plan which give rise to gains described in section 402(a)(2) or 403(a)(2), whichever applies. See section 871(a)(1)(B) and paragraph (c)(1)(i) of § 1.871-7. For exemption from withholding of tax at source on an annuity which is exempt from tax under section 871(f) and this paragraph, see paragraph (g) of § 1.1441-4.

(f) *Other exclusions.* Income which is from sources without the United States, as determined under the provisions of sections 861 through 863, and the regulations thereunder, is not included in the gross income of a nonresident alien individual unless such

income is effectively connected for the taxable year with the conduct of a trade or business in the United States by that individual. To determine specific exclusions in the case of other items which are from sources within the United States, see the applicable sections of the Code. For special rules under a tax convention for determining the sources of income and for excluding, from gross income, income from sources without the United States which is effectively connected with the conduct of a trade or business in the United States, see the applicable tax convention. For determining which income from sources without the United States is effectively connected with the conduct of a trade or business in the United States, see section 864(c)(4) and § 1.864-5.

(g) *Effective date.* This section shall apply for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 4, 1967 see 26 CFR 1.872-2 (Revised as of January 1, 1971).

[T.D. 7332, 39 FR 44228, Dec. 23, 1974]

§ 1.873-1 Deductions allowed nonresident alien individuals.

(a) *General provisions—(1) Allocation of deductions.* In computing the taxable income of a nonresident alien individual the deductions otherwise allowable shall be allowed only if, and to the extent that, they are connected with income from sources within the United States. No deduction shall be allowed in respect of any item, or portion thereof, which is not connected with income from such sources. For this purpose, the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder, except as may otherwise be provided by tax convention. Thus, from the items of gross income specifically from sources within the United States and from the items allocated thereto under the provisions of section 863(a), there shall be deducted (i) the expenses, losses, and other deductions which are connected with those items of income and are properly apportioned