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the government of a section 931 possession will not be considered an employee of the United States or of an agency of the United States.

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

Example. D, a United States citizen, files returns on a calendar year basis. In April 2008, D moves to American Samoa, where he purchases a house and accepts a permanent position with a local employer. For the remainder of the year and for the following three taxable years, D continues to live and work in American Samoa and has a closer connection to American Samoa than to the United States or any foreign country. Assuming that D otherwise meets the requirements under section 937(a) and §1.937–1(b) and (f)(1) (year-of-move exception), D is considered a bona fide resident of American Samoa for 2008. Accordingly, under section 931 and paragraph (a)(1) of this section, D should exclude from his 2008 Federal gross income any income from sources within American Samoa and any income that is effectively connected with the conduct of a trade or business within American Samoa, as determined under section 937(b) and §§1.937–2 and 1.937–3, as applicable.

(b) *Deductions and credits.* In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 931, there will 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 will apply (with creditable expenditures treated in the same manner as deductible expenditures).

(c) *Definitions.* For purposes of this section—

(1) The term *section 931 possession* means a possession that is a specified possession and that has entered into an implementing agreement, as described in section 1271(b) of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085), with the United States that is in effect for the entire taxable year;

(2) The term *specified possession* means Guam, American Samoa, or the Northern Mariana Islands;

(3) The rules of §1.937–1 will apply for determining whether an individual is a bona fide resident of a section 931 possession;

(4) The rules of §1.937–2 will apply for determining whether income is from sources within a section 931 possession; and

(5) The rules of §1.937–3 will apply for determining whether income is effectively connected with the conduct of a trade or business within a section 931 possession.

(d) *Effective/applicability date.* This section applies to taxable years ending after April 9, 2008.

[T.D. 9391, 73 FR 19360, Apr. 9, 2008]

§1.932–1 Coordination of United States and Virgin Islands income taxes.

(a) *Scope*—(1) *In general.* Section 932 and this section set forth the special rules relating to the filing of income tax returns and income tax liabilities of individuals described in paragraph (a)(2) of this section. Paragraph (h) of this section also provides special rules requiring consistent treatment of business entities in the United States and in the United States Virgin Islands (Virgin Islands).

(2) *Individuals covered.* This section will apply to any individual who—

(i) Is a bona fide resident of the Virgin Islands during the entire taxable year;

(ii)(A) Is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands) during the entire taxable year; and

(B) Has income derived from sources within the Virgin Islands, or effectively connected with the conduct of a trade or business within the Virgin Islands, for the taxable year; or

(iii) Files a joint return for the taxable year with any individual described in paragraph (a)(2)(i) or (ii) of this section.

(3) *Definitions.* For purposes of this section—

(i) The rules of §1.937–1 will apply for determining whether an individual is a bona fide resident of the Virgin Islands;

(ii) The rules of §1.937–2 will apply for determining whether income is from sources within the Virgin Islands; and

(iii) The rules of §1.937–3 will apply for determining whether income is effectively connected with the conduct of

a trade or business within the Virgin Islands.

(b) *U.S. individuals with Virgin Islands income*—(1) *Dual filing requirement.* Subject to paragraph (d) of this section, an individual described in paragraph (a)(2)(ii) of this section must make an income tax return for the taxable year to the United States and file a copy of such return with the Virgin Islands. Such individuals must also attach Form 8689, ''Allocation of Individual Income Tax to the U.S. Virgin Islands,'' to the U.S. income tax return and to the income tax return filed with the Virgin Islands.

(2) *Tax payments.* (i) Each individual to whom this paragraph (b) applies for the taxable year must pay the applicable percentage of the taxes imposed by this chapter for such taxable year (determined without regard to paragraph (b)(2)(ii) of this section) to the Virgin Islands.

(ii) A credit against the tax imposed by this chapter for the taxable year will be allowed in an amount equal to the taxes that are required to be paid to the Virgin Islands under paragraph (b)(2)(i) of this section and are so paid. Such taxes will be considered creditable in the same manner as taxes paid to the United States (for example, under section 31) and not as taxes paid to a foreign government (for example, under sections 27 and 901).

(iii) For purposes of this paragraph (b)(2)—

(A) The term *applicable percentage* means the percentage that Virgin Islands adjusted gross income bears to adjusted gross income;

(B) The term *Virgin Islands adjusted gross income* means adjusted gross income determined by taking into account only income derived from sources within the Virgin Islands and deductions properly apportioned or allocable to such income. For purposes of the preceding sentence, the rules of §1.861–8 will apply; and

(C) Pursuant to §1.937–2(a), the rules of §1.937–2(c)(1)(ii) and (c)(2) do not apply.

(c) *Bona fide residents of the Virgin Islands.* Subject to paragraph (d) of this section, an individual described in paragraph (a)(2)(i) of this section will be subject to the following income tax return filing requirements:

(1) *Virgin Islands filing requirements.* An individual to whom this paragraph (c) applies must file an income tax return for the taxable year with the Virgin Islands. On this return, the individual must report income from all sources and identify the source of each item of income shown on the return.

(2) *U.S. filing requirements.* (i) For purposes of calculating the income tax liability to the United States of an individual to whom this paragraph (c) applies, gross income will not include any amount included in gross income on the return filed with the Virgin Islands pursuant to paragraph (c)(1) of this section, and deductions and credits allocable to such income will not be taken into account, provided that—

(A) The individual fully satisfied the reporting requirements of paragraph (c)(1) of this section; and

(B) The individual fully paid the tax liability referred to in section 934(a) to the Virgin Islands with respect to such income.

(ii) For purposes of the U.S. statute of limitations under section 6501(a), an income tax return filed with the Virgin Islands by an individual who takes the position that he or she is a bona fide resident of the Virgin Islands described in paragraph (a)(2)(i) of this section (or an individual who files a joint return with such an individual under paragraph (d) of this section) will be deemed to be a U.S. income tax return, provided that the United States and the Virgin Islands have entered into an agreement for the routine exchange of income tax information satisfying the requirements of the Commissioner. The working arrangement announced in Notice 2007–31 satisfies the condition of the preceding sentence. See Notice 2007–31 (2007–16 IRB 971) (applicable to taxable years ending on or after December 31, 2006, unless and until arrangement terminates). In the absence of such an agreement, individuals to whom this paragraph (c) applies generally must file an income tax return for the taxable year with the United States to begin the period of limitations for Federal income tax purposes as provided in section 6501(a), and in such circumstances the Commissioner

may by revenue procedure, notice, or other administrative pronouncement specify U.S. filing and other information reporting requirements for such individuals. For taxable years ending before December 31, 2006, the rules provided in section 3 of Notice 2007–19 (2007–11 IRB 689) will apply. See §601.601(d)(2)(ii)(*b*).

(3) *U.S. tax payments.* In the case of an individual who is required to file an income tax return with the United States as a consequence of failing to satisfy the requirements of paragraphs (c)(2)(i)(A) or (B) of this section, there will be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the amount of the tax liability referred to in section 934(a) to the extent paid to the Virgin Islands. Such taxes shall be considered creditable in the same manner as taxes paid to the United States (for example, under section 31) and not as taxes paid to a foreign government (for example, under sections 27 and 901).

(d) *Joint returns.* In the case of married persons, if one or both spouses is an individual described in paragraph (a)(2) of this section and they file a joint return of income tax, the spouses must file their joint return with, and pay the tax due on such return to, the jurisdiction (or jurisdictions) where the spouse who has the greater adjusted gross income for the taxable year would be required under paragraph (b) or (c) of this section to file a return if separate returns were filed and all of their income were the income of such spouse. For this purpose, adjusted gross income of each spouse is determined under section 62 and the regulations under that section but without regard to community property laws; and, if one of the spouses dies, the taxable year of the surviving spouse will be treated as ending on the date of such death.

(e) *Place for filing returns*—(1) *U.S. returns.* Except as otherwise provided for returns filed under paragraph (c)(2)(ii) of this section, a return required under the rules of paragraphs (b) and (c) of this section to be filed with the United States must be filed as directed in the applicable forms and instructions.

(2) *Virgin Islands returns.* A return required under the rules of paragraphs (b) and (c) of this section to be filed with the Virgin Islands must be filed as directed in the applicable forms and instructions.

(f) *Tax accounting standards*—(1) *In general.* A dual filing taxpayer must use the same tax accounting standards on the returns filed with the United States and the Virgin Islands. A taxpayer who has filed a return only with the United States or only with the Virgin Islands as a single filing taxpayer for a prior taxable year and is required to file a return only with the other jurisdiction as a single filing taxpayer for a later taxable year may not, for such later taxable year, use different tax accounting standards unless the second jurisdiction consents to such change. However, such change will not be effective for returns filed thereafter with the first jurisdiction unless before such later date of filing the taxpayer also obtains the consent of the first jurisdiction to make such change. Any request for consent to make a change pursuant to this paragraph (f) must be made to the office where the return is required to be filed under paragraph (e) of this section and in sufficient time to permit a copy of the consent to be attached to the return for the taxable year.

(2) *Definitions.* For purposes of this paragraph (f), the terms—

(i) *Dual filing taxpayer* means a taxpayer who is required to file returns with the United States and the Virgin Islands for the same taxable year under the rules of paragraph (b) or (c) of this section;

(ii) *Single filing taxpayer* means a taxpayer who is required to file a return only with the United States (because the individual is not described in paragraph (a)(2) of this section) or only with the Virgin Islands (because the individual is described in paragraph (a)(2)(i) of this section and satisfies the conditions of paragraphs (c)(2)(i) and (ii) of this section) for the taxable year; and

(iii) *Tax accounting standards* includes the taxpayer's accounting period, methods of accounting, and any election to which the taxpayer is bound

with respect to the reporting of taxable income.

(g) *Extension of territory*—(1) *Section 932(a) taxpayers*—(i) *General rule.* With respect to an individual to whom section 932(a) applies for a taxable year, for purposes of taxes imposed by Chapter 1 of the Internal Revenue Code (Code), the United States generally will be treated, in a geographical and governmental sense, as including the Virgin Islands. The purpose of this rule is to facilitate the coordination of the tax systems of the United States and the Virgin Islands. Accordingly, the rule will have no effect where it is manifestly inapplicable or its application would be incompatible with the intent of any provision of the Code.

(ii) *Application of general rule.* Contexts in which the general rule of paragraph (g)(1)(i) of this section apply include—

(A) The characterization of taxes paid to the Virgin Islands. An individual to whom section 932(a) applies may take income tax required to be paid to the Virgin Islands under section 932(b) into account under sections 31, 6315, and 6402(b) as payments to the United States. Taxes paid to the Virgin Islands and otherwise satisfying the requirements of section 164(a) will be allowed as a deduction under that section, but income taxes required to be paid to the Virgin Islands under section 932(b) will be disallowed as a deduction under section 275(a);

(B) The determination of the source of income for purposes of the foreign tax credit (for example, sections 901 through 904). Thus, for example, after an individual to whom section 932(a) applies determines which items of income constitute income from sources within the Virgin Islands under the rules of section 937(b), such income will be treated as income from sources within the United States for purposes of section 904;

(C) The eligibility of a corporation to make a subchapter S election (sections 1361 through 1379). Thus, for example, for purposes of determining whether a corporation created or organized in the Virgin Islands may make an election under section 1362(a) to be a subchapter S corporation, it will be treated as a domestic corporation and a shareholder to whom section 932(a) applies will not be treated as a nonresident alien individual with respect to such corporation. While such an election is in effect, the corporation will be treated as a domestic corporation for all purposes of the Internal Revenue Code. For the consistency requirement with respect to entity status elections, see paragraph (h) of this section;

(D) The treatment of items carried over from other taxable years. Thus, for example, if an individual to whom section 932(a) applies has for a taxable year a net operating loss carryback or carryover under section 172, a foreign tax credit carryback or carryover under section 904, a business credit carryback or carryover under section 39, a capital loss carryover under section 1212, or a charitable contributions carryover under section 170, the carryback or carryover will be reported on the return filed in accordance with paragraph (b)(1) of this section, even though the return of the taxpayer for the taxable year giving rise to the carryback or carryover was required to be filed with the Virgin Islands under section 932(c); and

(E) The treatment of property exchanged for property of a like kind (section 1031). Thus, for example, if an individual to whom section 932(a) applies exchanges real property located in the United States for real property located in the Virgin Islands, notwithstanding the provisions of section 1031(h), such exchange may qualify as a like-kind exchange under section 1031 (provided that all the other requirements of section 1031 are satisfied).

(iii) *Nonapplication of the general rule.* Contexts in which the general rule of paragraph (g)(1)(i) of this section does not apply include—

(A) The application of any rules or regulations that explicitly treat the United States and any (or all) of its possessions as separate jurisdictions (for example, sections 931 through 937, 7651, and 7654).

(B) The determination of any aspect of an individual's residency (for example, sections 937(a) and 7701(b)). Thus,

for example, an individual whose principal place of abode is in the Virgin Islands is not considered to have a principal place of abode in the United States for purposes of section 32(c);

(C) The characterization of a corporation for purposes other than subchapter S (for example, sections 367, 951 through 964, 1291 through 1298, 6038, and 6038B). Thus, for example, if an individual to whom section 932(a) applies transfers appreciated tangible property to a corporation created or organized in the Virgin Islands in a transaction described in section 351, he or she must recognize gain unless an exception under section 367(a) applies. Also, if a corporation created or organized in the Virgin Islands qualifies as a passive foreign investment company under sections 1297 and 1298 with respect to an individual to whom section 932(a) applies, a dividend paid to such shareholder does not constitute qualified dividend income under section 1(h)(11)(B).

(2) *Section 932(c) taxpayers*—(i) *General rule.* With respect to an individual to whom section 932(c) applies for a taxable year, for purposes of the territorial income tax of the Virgin Islands (that is, mirrored sections of the Code), the Virgin Islands generally will be treated, in a geographical and governmental sense, as including the United States. The purpose of this rule is to facilitate the coordination of the tax systems of the United States and the Virgin Islands. Accordingly, the rule will have no effect where it is manifestly inapplicable or its application would be incompatible with the intent of any provision of the Code.

(ii) *Application of general rule.* Contexts in which the general rule of paragraph (g)(2)(i) of this section apply include—

(A) The characterization of taxes paid to the United States. A taxpayer described in section 932(c)(1) may take income tax paid to the United States into account under mirrored sections 31, 6315, and 6402(b) as payments to the Virgin Islands;

(B) The determination of the source of income for purposes of the foreign tax credit (for example, mirrored sections 901 through 904). Thus, for example, any item of income that constitutes income from sources within the United States under the rules of sections 861 through 865 will be treated as income from sources within the Virgin Islands for purposes of mirrored section 904;

(C) The eligibility of a corporation to make a subchapter S election (mirrored sections 1361 through 1379). Thus, for example, for purposes of determining whether a corporation created or organized in the United States may make an election under mirrored section 1362(a) to be a subchapter S corporation, it will be treated as a domestic corporation and a shareholder to whom section 932(c) applies will not be treated as a nonresident alien individual with respect to such corporation. While such an election is in effect, the corporation will be treated as a domestic corporation for all purposes of the territorial income tax. For the consistency requirement with respect to entity status elections, see paragraph (h) of this section;

(D) The treatment of items carried over from other taxable years. Thus, for example, if an individual to whom section 932(c) applies has for a taxable year a net operating loss carryback or carryover under mirrored section 172, a foreign tax credit carryback or carryover under mirrored section 904, a business credit carryback or carryover under mirrored section 39, a capital loss carryover under mirrored section 1212, or a charitable contributions carryover under mirrored section 170, the carryback or carryover will be reported on the return filed in accordance with paragraph (c)(1) of this section, even though the return of the taxpayer for the taxable year giving rise to the carryback or carryover was required to be filed with the United States; and

(E) The treatment of property exchanged for property of a like kind (mirrored section 1031). Thus, for example, if an individual to whom section 932(c) applies exchanges real property located in the United States for real property located in the Virgin Islands, notwithstanding the provisions of mirrored section 1031(h), such exchange may qualify as a like-kind exchange under mirrored section 1031 (provided that all the other requirements of mirrored section 1031 are satisfied).

(iii) *Nonapplication of general rule.* Contexts in which the general rule of paragraph (g)(2)(i) of this section does not apply include—

(A) The determination of any aspect of an individual's residency (for example, mirrored section 7701(b)). Thus, for example, an individual whose principal place of abode is in the United States is not considered to have a principal place of abode in the Virgin Islands for purposes of mirrored section 32(c).

(B) The determination of the source of income for purposes other than the foreign tax credit (for example, sections 932(a) and (b), 934(b), and 937). Thus, for example, compensation for services performed in the United States and rentals or royalties from property located in the United States do not constitute income from sources within the Virgin Islands for purposes of section 934(b); and

(C) The definition of wages (mirrored section 3401). Thus, for example, services performed by an employee for an employer in the United States do not constitute services performed in the Virgin Islands under mirrored section 3401(a)(8).

(h) *Entity status consistency requirement*—(1) *In general.* Taxpayers should make consistent entity status elections (as defined in paragraph (h)(3) of this section), where applicable, in both the United States and the Virgin Islands. In the case of a business entity to which this paragraph (h) applies—

(i) If an entity status election is filed with the Internal Revenue Service (IRS) but not with the Virgin Islands Bureau of Internal Revenue (BIR), the Director of the BIR or his delegate, at his discretion, may deem the election also to have been made for Virgin Islands tax purposes;

(ii) If an entity status election is filed with the BIR but not with the IRS, the Commissioner, at his discretion, may deem the election also to have been made for Federal tax purposes; and

(iii) If inconsistent entity status elections are filed with the BIR and the IRS, both the Commissioner and the Director of the BIR or his delegate may, at their individual discretion, treat the elections they each received as invalid and may deem the election filed in the other jurisdiction to have been made also for tax purposes in their own jurisdiction. See Rev. Proc. 2006–23 (2006–1 CB 900) (see §601.601(d)(2)(ii)(*b*) of this chapter) for procedures for requesting the assistance of the IRS when a taxpayer is or may be subject to inconsistent tax treatment by the IRS and a U.S. possession tax agency.

(2) *Scope.* This paragraph (h) applies to the following business entities:

(i) A business entity (as defined in §301.7701–2(a) of this chapter) that is domestic (as defined in §301.7701–5 of this chapter), or otherwise treated as domestic for purposes of the Code, and that is owned in whole or in part by any person who is either a bona fide resident of the Virgin Islands or a business entity created or organized in the Virgin Islands.

(ii) A business entity that is created or organized in the Virgin Islands and that is owned in whole or in part by any U.S. person (other than a bona fide resident of the Virgin Islands).

(3) *Definition.* For purposes of this section, the term *entity status election* includes an election under §301.7701–3(c) of this chapter, an election under section 1362(a), and any other similar elections.

(4) *Default status.* Solely for the purpose of determining classification of an eligible entity under §301.7701–3(b) of this chapter and under that section as mirrored in the Virgin Islands, an eligible entity subject to this paragraph (h) will be classified for both Federal and Virgin Islands tax purposes using the rule that applies to domestic eligible entities.

(5) *Transition rules*—(i) In the case of an election filed prior to April 11, 2005, except as provided in paragraph (h)(5)(ii) of this section, the rules of paragraph (h)(1) of this section will apply as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(ii) In the unlikely circumstance that inconsistent elections described in paragraph (h)(1)(iii) of this section are filed prior to April 11, 2005, and the entity cannot change its classification to achieve consistency because of the sixty-month limitation described in §301.7701–3(c)(1)(iv) of this chapter,

then the entity may nevertheless request permission from the Commissioner or the Director of the BIR or his delegate to change such election to avoid inconsistent treatment by the Commissioner and the Director of the BIR or his delegate.

(iii) Except as provided in paragraphs (h)(5)(i) and (h)(5)(ii) of this section, in the case of an election filed with respect to an entity before it became an entity described in paragraph (h)(2) of this section, the rules of paragraph (h)(1) of this section will apply as of the first day that such entity is described in paragraph (h)(2) of this section.

(iv) In the case of an entity created or organized prior to April 11, 2005, paragraph (h)(4) of this section will take effect for Federal income tax purposes (or Virgin Islands income tax purposes, as the case may be) as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(i) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. (i) A is a U.S. citizen who resides in State R. For 2008, A files with the IRS a Form 1040, ''U.S. Individual Income Tax Return,'' reporting adjusted gross income of $90x, which includes $30x from sources in the Virgin Islands. The income tax liability reported on A's Form 1040 is $18x. A files a copy of his Form 1040 with the Virgin Islands as required by section 932(a)(2) and paragraph (b)(1) of this section. A pays to the Virgin Islands the applicable percentage of his Federal income tax liability as required by section 932(b) and paragraph (b)(2) of this section, computed as follows: $30x/$90x × $18x = $6x income tax liability to the Virgin Islands.

(ii) A claims a credit in the amount of $6x against his Federal income tax liability reported on his Form 1040. A attaches a Form 8689, ''Allocation of Individual Income Tax to the U.S. Virgin Islands,'' to the Form 1040 filed with the IRS and to the copy filed with the Virgin Islands.

Example 2. (i) B, a U.S. citizen, files returns on a calendar year basis. In November 2008, B moves to the Virgin Islands, purchases a house, and accepts a permanent position with a local employer. For the remainder of the year and throughout 2009, B continues to live and work in the Virgin Islands and has a closer connection to the Virgin Islands than to the United States or any foreign country. As a consequence of his employment in the Virgin Islands, B earns income from the performance of services in the Virgin Islands during 2008 and 2009.

(ii) For 2008, B does not qualify as a bona fide resident under section 937(a) and §1.937–1(b) and (f)(1). Therefore, B is subject to the rules of sections 932(a) and (b) and paragraph (b) of this section for 2008 because he has income derived from sources within the Virgin Islands as determined under the rules of section 937(b) and §1.937–2.

(iii) For 2009, assuming that B otherwise satisfies the requirements of section 937(a) and §1.937–1(b), B qualifies as a bona fide resident of the Virgin Islands. Therefore, section 932(c) and paragraph (c) of this section apply to B for 2009, and he must file his income tax return with the Virgin Islands under paragraph (c)(1) of this section. Provided that B fully satisfies the reporting requirements of paragraph (c)(1) of this section and fully pays the tax liability referred to in section 934(a), B will have no Federal income tax filing requirement or liability under paragraphs (c)(2) and (3) of this section.

Example 3. H and W are U.S. citizens. H resides in State T and W is a bona fide resident of the Virgin Islands. For 2008, H and W prepare a joint Form 1040, ''U.S. Individual Income Tax Return,'' reporting total adjusted gross income of $75x, of which $40x is attributable to compensation that W received for services performed in the Virgin Islands and $35x to compensation that H received for services performed in State T. Pursuant to section 932(d) and paragraph (d) of this section, because W would have the greater adjusted gross income if computed separately, H and W must file their joint Form 1040 with the Virgin Islands as required by section 932(c) and paragraph (c)(1) of this section. H and W may claim a tax credit on such return for income tax withheld during 2008 and paid to the IRS.

Example 4. (i) The facts are the same as in *Example 3*, except that H also earns $25x for services performed in the Virgin Islands, 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, because H would have the greater adjusted gross income if computed separately, H and W must file their joint Form 1040 with the IRS and must file a copy of that joint Form 1040 with the Virgin Islands as required by section 932(a)(2) and paragraph (b)(1) of this section. H and W must pay the applicable percentage of their Federal income tax liability to the Virgin Islands as required by section 932(b) and paragraph (b)(2) of this section, computed as follows: $65x /$100x × $20x = $13x income tax liability to the Virgin Islands.

(iii) H and W claim a credit against their Federal income tax liability reported on their joint Form 1040 in the amount of $13x,

the portion of their Federal income tax liability required to be paid to the Virgin Islands. H and W attach a Form 8689, ''Allocation of Individual Income Tax to the U.S. Virgin Islands,'' to their joint Form 1040 filed with the IRS and to the copy filed with the Virgin Islands.

Example 5. N, a U.S. citizen and calendar year taxpayer, takes the position that he is a bona fide resident of the Virgin Islands for the 2007 taxable year. On April 15, 2008, N files a Form 1040, ''U.S. Individual Income Tax Return,'' with the Virgin Islands for his 2007 taxable year. N does not file a Form 1040 with the IRS. Because there is an agreement in force between the United States and the Virgin Islands for the routine exchange of income tax information, under paragraph (c)(2)(ii) of this section, the Federal 3-year period of limitations under section 6501(a) will expire on April 15, 2011, and the IRS will make no further assessment of income tax after that date for N's 2007 taxable year except as otherwise authorized by section 6501.

Example 6. (i) J is a U.S. citizen and a bona fide resident of the Virgin Islands. In 2008, J receives compensation for services performed as an employee in the Virgin Islands in the amount of $40x. J files with the Virgin Islands a Form 1040, ''U.S. Individual Income Tax Return,'' reporting gross income of only $30x. Based on these facts, J has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for Federal income tax purposes.

(ii) The facts are the same as in paragraph (i) of this *Example 6* except that on or before the last day prescribed for filing an income tax return for J's 2008 taxable year, J files with the Virgin Islands an amended Form 1040 for 2008, correctly reporting the full $40x of compensation. Provided that J otherwise fully satisfies the reporting requirements of paragraph (c)(1) of this section and fully pays the tax liability referred to in section 934(a), J will have no Federal income tax filing requirement or liability under paragraphs (c)(2) and (3) of this section.

Example 7. (i) N is a U.S. citizen and a bona fide resident of the Virgin Islands. In 2008, N receives compensation for services performed in Country M. N files with the Virgin Islands a Form 1040, ''U.S. Individual Income Tax Return,'' reporting the compensation as income effectively connected with the conduct of a trade or business in the Virgin Islands. N claims a special credit against the tax on this compensation pursuant to a Virgin Islands 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 §1.937–3(b), compensation for services performed outside the Virgin Islands may not be treated as income effectively connected with the conduct of a trade or business in the Virgin Islands for purposes of section 934(b). Consequently, N is not entitled to claim the special credit under Virgin Islands law with respect to N's income from services performed in Country M. Because 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 Federal income tax purposes. Therefore, income reported on the Form 1040 as filed with the Virgin Islands must be included in N's Federal gross income. Under paragraph (c)(3) of this section, the amount of tax paid to the Virgin Islands on such income will be allowed as a credit against N's Federal income tax liability.

(j) *Effective/applicability date.* Except as otherwise provided in this paragraph (j), this section applies to taxable years ending after April 9, 2008. Taxpayers may choose to apply paragraph (c)(2)(ii) of this section to open taxable years ending on or after December 31, 2006.

[T.D. 9391, 73 FR 19361, Apr. 9, 2008, as amended at T.D. 9391, 73 FR 27728, May 14, 2007; T.D. 9391, 76 FR 4244, Jan. 25, 2011]

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

(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, will 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. For purposes of section 933 and this section, an employee of the government of Puerto Rico will not be considered an employee of the United States or of an agency of the United States.

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

Example. E, a United States citizen, files returns on a calendar year basis. In April 2008, E moves to Puerto Rico, where he purchases a house and accepts a permanent position with a local employer. For the remainder of the year and for the following three taxable years, E continues to live and work in Puerto Rico and has a closer connection to Puerto Rico than to the United States or any foreign country. Assuming that E otherwise meets the requirements under section 937(a) and §1.937–1(b) and (f)(1) (year-of-move