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of covered intangibles described in section 936(h)(5)(C)(i)(II)(*c*) related to the product in order for the possessions corporation to receive a full return with respect to such intangibles?

A. 6: No. For purposes of section 936(h), it is immaterial whether such covered intangibles are owned by the possessions corporation or by another member of the affiliated group. Moreover, if the legal owner of such covered intangibles which are subject to section 936(h)(5) is an affiliate of the possessions corporation, such person will not be required to charge an arm's-length royalty under section 482 to the possessions corporation.

[T.D. 8090, 51 FR 21532, June 13, 1986; 51 FR 27174, July 30, 1986, as amended by T.D. 8669, 61 FR 21367, May 10, 1996; 61 FR 39072, July 26, 1996; T.D. 8786, 63 FR 55025, Oct. 14, 1998]

§ 1.936–7 Manner of making election under section 936 (h)(5); special election for export sales; revocation of election under section 936(a).

(a) The rules in this section apply for purposes of section 936(h) and also for purposes of section 934(e), where applicable.

(b) *Manner of making election.*

Q. 1: How does a possessions corporation make an election to use the cost sharing method or profit split method?

A. 1: A possessions corporation makes an election to use the cost sharing or profit split method by filing Form 5712–A (''Election and Verification of the Cost Sharing or Profit Split Method Under Section 936(h)(5)'') and attaching it to its tax return. Form 5712–A must be filed on or before the due date (including extensions) of the tax return of the possessions corporation for its first taxable year beginning after December 31, 1982. The electing corporation must set forth on the form the name and the taxpayer identification number or address of all members of the affiliated group (including foreign affiliates not required to file a U.S. tax return). All members of the affiliated group must consent to the election. For elections filed with respect to taxable years beginning before January 1, 2003, an authorized officer of the electing corporation must sign the statement of election and must declare that he has received a signed statement of consent from an authorized officer, director, or other appropriate official of each member of the affiliated group. Elections filed for taxable years beginning after December 31, 2002, must incorporate a declaration by the electing corporation that it has received a signed consent from an authorized officer, director, or other appropriate official of each member of the affiliated group and will be verified by signing the return. The election is not valid for a taxable year unless all affiliates consent. A failure to obtain an affiliate's written consent will not invalidate the election out if the possessions corporation made a good faith effort to obtain all the necessary consents or the failure to obtain the missing consent was inadvertent.

Subsequently created or acquired affiliates are bound by the election. If an election out is revoked under section 936(h)(5)(F)(iii), a new election out with respect to that product area cannot be made without the consent of the Commissioner. The possessions corporation shall file an amended Form 5712–A with its timely filed (including extensions) income tax return to reflect any changes in the names or number of the members of the affiliated group for any taxable year after the first taxable year to which the election out applies. By consenting to the election out, all affiliates agree to provide information necessary to compute the cost sharing payment under the cost sharing method or combined taxable income under the profit split method, and failure to provide such information shall be treated as a request to revoke the election out under section 936(h)(5)(F)(iii).

Q. 2: May the ''election out'' under section 936(h)(5) be made on a product-by-product basis, or must it be made on a wide basis?

A. 2: An electing corporation is required to treat products in the same product area in the same manner. Similarly, all possessions corporations in the same affiliated group that produce any products or render any services in the same product area must make the same election for all products that fall within the same product area. However, §1.936–7(b) provides that the electing corporation may make a different election for export sales than for domestic sales. The electing corporation or corporations may also make different elections for products that fall within different product areas.

Q. 3: May the possessions corporation elect to define product area more narrowly than the 3-digit SIC code?

A. 3: No. Certain alternatives, such as the 4-digit SIC code, would not be permitted under the statute. However, other methods for defining product area may be considered by the Commissioner in the future.

Q. 4: May a possessions corporation make an election out under the cost sharing method with respect to a product area if the affiliated group incurs no research, development or experimental costs in the product area?

A. 4: Yes. In that case the cost sharing payment will be zero.

Q. 5: If the significant business presence test is not satisfied for a product or type of service within the product area covered by the election out under section 936(h)(5) what rules will apply with respect to that product?

A. 5: With respect to the product which does not satisfy the significant business presence test, the provisions of section 936 (h)(1) through (h)(4) will apply to the allocation of income. However, if a cost sharing or a profit split election has been made with respect to the product area, the cost sharing payment or the research and development floor under section 936(h)(5)(C)(ii)(II) will not be reduced.

Q. 6: Is a taxpayer permitted to make a change of election with respect to the cost sharing and profit split methods?

A. 6: In general, once the election is properly made, it is binding for the first year in which it applies and all subsequent years (including upon any later created or acquired affiliates), and revocation is only permitted with the consent of the Commissioner of Internal Revenue. However, a taxpayer will be permitted to change its election once from the cost sharing method to the profit split method or *vice versa*, or from the method permitted under section 936 (h)(1) through (h)(4) to cost sharing or profit split or *vice versa*, without the consent of the Commissioner if the change is made on the taxpayer's return for its first taxable year ending after June 13, 1986. Such change will apply to such taxable year and all subsequent taxable years, and, at the taxpayer's option, may also apply to all prior taxable years for which section 936(h) was in effect. A change of election will be treated as an election subject to the procedures set forth above and to section 481 of the Internal Revenue Code.

Q. 7: If the Commissioner determines that a possessions corporation does not meet the 80-percent possession source test or the 65-percent active trade or business test (the ''qualification tests'') for any taxable year beginning after 1982, under what circumstances is the possessions corporation permitted to make a distribution of property

after the close of its taxable year to meet the qualification tests?

A. 7: A possessions corporation may make a pro rata distribution of property to its shareholders after the close of the taxable year if the Commissioner determines that the possessions corporation does not satisfy the qualification tests (a) by reason of the exclusion from gross income of intangible income under section 936(h)(1)(B) or section 936(h)(5)(C)(i)(II) or (b) by reason of the allocation to the shareholders of the possessions corporation of income under section 936(h)(5)(C)(ii)(III); provided, however, that the determination of the Commissioner does not contain a finding that the failure of such corporation to satisfy the qualification tests was due, in whole or in part, to fraud with intent to evade tax or willful neglect on the part of the possessions corporation. The possessions corporation must designate the distribution at the time the distribution is made as a distribution to meet qualification requirements, and it will be subject to the provisions of section 936(h)(4). Such distributions will not qualify for the dividends received deduction.

Q. 8: If a possessions corporation owns stock in a subsidiary possessions corporation, any intangible property income allocated to the parent possessions corporation under section 936(h) will be treated as U.S. source income and taxable to the parent possessions corporation. Is the intangible property income taken into consideration in determining whether the parent possessions corporation meets the income tests of section 936(a)(2)?

A. 8: While taxable to the parent possessions corporation, the intangible property income does not enter into the calculation of the 80-percent possession source test or the 65-percent active trade or business test of section 936(a)(2)(A) and (B). This would also be the case if the subsidiary possessions corporation made a qualifying distribution under section 936(h)(4).

(c) *Separate election for export sales.*

Q. 1: What methods of computing income can a possessions corporation use under the separate election for export sales?

A. 1: The only two methods which are available under the separate election for export sales are the cost sharing method and the profit split method.

Q. 2: What is the definition of export sales for purposes of the separate election for export sales?

A. 2: The determination of export sales is based upon the destination of the product, *i.e.*, where it is to be used or consumed. If the product is sold to a U.S. affiliate, it will be treated as an export sale only if resold or otherwise transferred abroad to a foreign person (including a foreign affiliate or foreign branch of a U.S. affiliate) within one year from the date of sale to the U.S. affiliate for ultimate use or consumption outside the United States as provided under §1.954–3(a)(3)(ii).

Q. 3: Assume that a possessions corporation sells a product to both foreign affiliates and foreign branches of U.S. affiliates. In addition, it sells the product to its U.S. parent for resale in the U.S. The possessions corporation makes a profit split election for domestic sales and a cost sharing election of export sales. Will the sales to foreign branches of U.S. affiliates be treated as exports subject to the cost sharing method or as domestic sales subject to the profit split method?

A. 3: The sales to a foreign branch of a U.S. corporation are exports if for ultimate use or consumption outside of the United States as provided under §1.954–3(a)(3)(ii).

Q. 4: Under what circumstances may a possessions corporation make the separate election under section 936(h)(5)(F)(iv)(II) for computing its income from products exported to a foreign person when the income derived by such foreign person on the resale of such products is included in foreign base company income under section 954(a)?

A. 4: If the income derived by a foreign person on the resale of products manufactured, in whole or in part, by a possessions corporation is included in foreign base company income under section 954(a), then the possessions corporation may make the separate export election under section 936(h)(5)(F)(iv)(II) for computing its income from such products only if such foreign person has been formed or is

availed of for substantial business reasons that are unrelated to an affiliated corporation's U.S. tax liability. For purposes of the proceding sentence, a foreign person will be considered to be formed or availed of for such substantial business reasons if the foreign person in the normal course of business purchases substantial quantities of products from both the possessions corporation and its affiliates for resale, and, in addition provides support services for affiliated companies such as centralized testing, marketing of products, management of local currency exposures, or other similar services. However, a foreign person that purchases and resells products only from a possessions corporation is presumed to be formed or availed of for other than such substantial business reasons, even if the foreign person provides additional services.

Q. 5: When will the ''manufacturing'' test set forth in subsection (d)(1)(A) of section 954 be applicable to the export sales of a product of a possessions corporation which makes a separate election for export sales?

A. 5: An electing corporation will be required to meet the ''manufacturing'' test set forth in subsection (d)(1)(A) of section 954 with respect to export sales of its product in each taxable year in which the separate election for export sales is in effect.

(d) *Revocation of election under section 936(a).*

Q. 1: When may an election under section 936(a) be revoked?

A. 1: An election under section 936(a) may be revoked during the first ten years of section 936 status only with the consent of the Commissioner, and without the Commissioner's consent after that time. The Commissioner hereby consents to all requests for revocation that are made with respect to the taxapayer's first taxable year beginning after December 31, 1982 provided that the section 936(a) election was in effect for the corporation's last taxable year beginning before January 1, 1983, if the taxpayer agrees not to reelect section 936(a) prior to its first taxable year beginning after December 31, 1988. A taxpayer that wishes to revoke a section 936(a) election under the terms of the blanket revocation must attach a ''Statement of Revocation—Section 936'' to the taxpayer's timely filed return (including extensions) and must state that in revoking the election the taxpayer agrees not to re-elect section 936(a) prior to its first taxable year beginning after December 31, 1988. Other requests to revoke not covered by the Commissioner's blanket consent should be addressed to the District Director having jurisdiction over the taxpayer's tax return.

[T.D. 8090, 51 FR 21545, June 13, 1986, as amended by T.D. 9100, 68 FR 70705, Dec. 19, 2003; T.D. 9300, 71 FR 71042, Dec. 8, 2006]

§ 1.936–8T Qualified possession source investment income (temporary). [Reserved]

§ 1.936–9T Source of qualified possession source investment income (temporary). [Reserved]

§ 1.936–10 Qualified investments.

(a) *In general.* [Reserved]

(b) *Qualified investments in Puerto Rico.* [Reserved]

(c) *Qualified investment in certain Caribbean Basin countries*—(1) *General rule.* An investment of qualified funds described in this section shall be treated as a qualified investment of funds for use in Puerto Rico if the funds are used for a qualified investment in a qualified Caribbean Basin country. A qualified investment in a qualified Caribbean Basin country is a loan of qualified funds by a qualified financial institution (described in paragraph (c)(3) of this section) directly to a qualified recipient (described in paragraph (c)(9) of this section) or indirectly through a single financial intermediary for investment in active busines assets (as defined in paragraph (c)(4) of this section) in a qualified Caribbean Basin country (described in paragraph (c)(10)(ii) of this section) or for investment in development projects (as defined in paragraph (c)(5) of this section) in a qualified Caribbean Basin country, provided—

(i) The investment is authorized, prior to disbursement of the funds, by the Commissioner of Financial Institutions of Puerto Rico (or his delegate) pursuant to regulations issued by such Commissioner; and