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investment trust or a regulated investment company, a participant in a common trust fund, or a patron of an organization to which part I of subchapter T applies and if the amount so allocated is governed by section 860E(d)(2) (treating it ''as an excess inclusion with respect to a residual interest held by'' the taxpayer), the amount shall be taken into account for purposes of sections 871(a), 881, 1441, and 1442 at the same time as the time prescribed for other income of the shareholder, participant, or patron from the trust, company, fund, or organization.

[T.D. 8458, 57 FR 61313, Dec. 24, 1992, as amended by T.D. 9272, 71 FR 43365, Aug. 1, 2006; T.D. 9415, 73 FR 40172, July 14, 2008]

TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

DETERMINATION OF SOURCES OF INCOME

§ 1.861–1 Income from sources within the United States.

(a) *Categories of income.* Part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder determine the sources of income for purposes of the income tax. These sections explicitly allocate certain important sources of income to the United States or to areas outside the United States, as the case may be; and, with respect to the remaining income (particularly that derived partly from sources within and partly from sources without the United States), authorize the Secretary or his delegate to determine the income derived from sources within the United States, either by rules of separate allocation or by processes or formulas of general apportionment. The statute provides for the following three categories of income:

(1) *Within the United States.* The gross income from sources within the United States, consisting of the items of gross income specified in section 861(a) plus the items of gross income allocated or apportioned to such sources in accordance with section 863(a). See §§ 1.861–2 to 1.861–7, inclusive, and § 1.863–1. The taxable income from sources within the United States, in the case of such income, shall be determined by deducting therefrom, in accordance with sections 861(b) and 863(a), the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. See §§ 1.861–8 and 1.863–1.

(2) *Without the United States.* The gross income from sources without the United States, consisting of the items of gross income specified in section 862(a) plus the items of gross income allocated or apportioned to such sources in accordance with section 863(a). See §§ 1.862–1 and 1.863–1. The taxable income from sources without the United States, in the case of such income, shall be determined by deducting therefrom, in accordance with sections 862(b) and 863(a), the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. See §§ 1.862–1 and 1.863–1.

(3) *Partly within and partly without the United States.* The gross income derived from sources partly within and partly without the United States, consisting of the items specified in section 863(b)(1), (2), and (3). The taxable income allocated or apportioned to sources within the United States, in the case of such income, shall be determined in accordance with section 863 (a) or (b). See §§ 1.863–2 to 1.863–5, inclusive.

(4) *Exceptions.* An owner of certain aircraft or vessels first leased on or before December 28, 1980, may elect to treat income in respect of these aircraft or vessels as income from sources within the United States for purposes of sections 861(a) and 862(a). See § 1.861–9. An owner of certain aircraft, vessels, or spacecraft first leased after December 28, 1980, must treat income in respect of these craft as income from sources within the United States for purposes of sections 861(a) and 862(a). See § 1.861–9A.

(b) *Taxable income from sources within the United States.* The taxable income from sources within the United States shall consist of the taxable income described in paragraph (a)(1) of this section plus the taxable income allocated

or apportioned to such sources, as indicated in paragraph (a)(3) of this section.

(c) *Computation of income.* If a taxpayer has gross income from sources within or without the United States, together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto, shall be segregated; and the taxable income from sources within the United States shall be separately computed therefrom.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 7928, 48 FR 55845, Dec. 16, 1983]

§ 1.861–2 Interest.

(a) *In general.* (1) Gross income consisting of interest from the United States or any agency or instrumentality thereof (other than a possession of the United States or an agency or instrumentality of a possession), a State or any political subdivision thereof, or the District of Columbia, and interest from a resident of the United States on a bond, note, or other interest-bearing obligation issued, assumed or incurred by such person shall be treated as income from sources within the United States. Thus, for example, income from sources within the United States includes interest received on any refund of income tax imposed by the United States, a State or any political subdivision thereof, or the District of Columbia. Interest other than that described in this paragraph is not to be treated as income from sources within the United States. See paragraph (a)(7) of this section for special rules concerning substitute interest paid or accrued pursuant to a securities lending transaction.

(2) The term ''resident of the United States'', as used in this paragraph, includes (i) an individual who at the time of payment of the interest is a resident of the United States, (ii) a domestic corporation, (iii) a domestic partnership which at any time during its taxable year is engaged in trade or business in the United States, or (iv) a foreign corporation or a foreign partnership, which at any time during its taxable year is engaged in trade or business in the United States.

(3) The method by which, or the place where, payment of the interest is made is immaterial in determining whether interest is derived from sources within the United States.

(4) For purposes of this section, the term ''interest'' includes all amounts treated as interest under section 483, and the regulations thereunder. It also includes original issue discount, as defined in section 1232(b)(1), whether or not the underlying bond, debenture, note, certificate, or other evidence of indebtedness is a capital asset in the hands of the taxpayer within the meaning of section 1221.

(5) If interest is paid on an obligation of a resident of the United States by a nonresident of the United States acting in the nonresident's capacity as a guarantor of the obligation of the resident, the interest will be treated as income from sources within the United States.

(6) In the case of interest received by a nonresident alien individual or foreign corporation this paragraph (a) applies whether or not the interest is effectively connected for the taxable year with the conduct of a trade or business in the United States by such individual or corporation.

(7) A substitute interest payment is a payment, made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction, of an amount equivalent to an interest payment which the owner of the transferred security is entitled to receive during the term of the transaction. A securities lending transaction is a transfer of one or more securities that is described in section 1058(a) or a substantially similar transaction. A sale-repurchase transaction is an agreement under which a person transfers a security in exchange for cash and simultaneously agrees to receive a substantially identical securities from the transferee in the future in exchange for cash. A substitute interest payment shall be sourced in the same manner as the interest accruing on the transferred security for purposes of this section and § 1.862–1. See also §§ 1.864–5(b)(2)(iii), 1.871–7(b)(2), 1.881–2(b)(2) and for the character of such payments and § 1.894–1(c) for the