

taxpayer's facts—property within the state over total property, payroll within the state over total payroll, and sales within the state over total sales—and, with adjustments, provide a reasonable method for this purpose. When applying the rules of UDITPA to estimate U.S. source income derived from state A activities, the taxpayer's UDITPA factors must be adjusted to eliminate both taxable income and factors attributable to a foreign branch. Therefore, in the example in this paragraph (g)(27) all taxable income as well as UDITPA apportionment factors (property, payroll, and sales) attributable to USP's Country Y branch must be eliminated.

(3)(i) Since it is presumed that, if state A had had an income tax, state A would not attempt to tax the income derived by USP's Country Y branch, any reasonable estimate of the income that would be taxed by state A must exclude any foreign source income.

(ii) When using the rules of UDITPA to estimate the income that would have been taxable by state A in these facts, foreign source income is excluded by starting with federally defined taxable income (before deduction for state income taxes) and subtracting any income derived by USP's Country Y branch. The hypothetical state A taxable income is then determined by multiplying the resulting difference by the average of USP's state A property, payroll, and sales ratios, determined using the principles of UDITPA (after adjustment by eliminating the Country Y branch factors). The resulting product is presumed to be exclusively U.S. source income, and the allocation and apportionment method described in paragraph (g)(26) of this section (*Example 26*) must then be applied.

(iii) If, for example, state A taxable income were determined to equal \$550,000x, then \$550,000x of U.S. source income for Federal income tax purposes would be presumed to constitute state A taxable income. Under paragraph (g)(26) of this section (*Example 26*), the remaining \$250,000x (\$800,000x - \$550,000x) of U.S. source income for Federal income tax purposes would be presumed to be subject to tax in states B and C. Since states B and C impose tax on \$400,000x, the application

of *Example 25* would result in a presumption that \$150,000x is foreign source income and \$250,000x is domestic source income. The deduction for the \$14,000x of income taxes of states B and C would therefore be related and allocable to both foreign source and domestic source income and would be subject to apportionment.

(B) *Apportionment*. The deduction of \$14,000x for income taxes of states B and C is apportioned in the same manner as in paragraph (g)(26) of this section (*Example 26*). As a result, \$5,250x of the \$14,000x of state B and state C income taxes is apportioned to foreign source foreign branch category income (\$14,000x × \$150,000x/\$400,000x), and \$8,750x (\$14,000x × \$250,000x/\$400,000x) of the \$14,000x of state B and state C income taxes is apportioned to U.S. source income.

(h) *Applicability date*. (1) Except as provided in this paragraph (h), this section applies to taxable years that both begin after December 31, 2017, and end on or after December 4, 2018.

(2) Paragraphs (d)(2)(ii)(B), (d)(2)(v), (e)(4) and (5), (e)(6)(i), (e)(8) and (16), and (g)(15) through (18) of this section apply to taxable years that begin after December 31, 2019. For taxable years that both begin after December 31, 2017, and end on or after December 4, 2018, and also begin on or before December 31, 2019, see § 1.861-8(d)(2)(ii)(B), (e)(4) and (5), (e)(6)(i), and (e)(8) as in effect on December 17, 2019.

(3) The last sentence of paragraph (d)(2)(ii)(C)(I) of this section and paragraph (f)(1)(vi)(N) of this section apply to taxable years beginning on or after January 1, 2021.

(4) Paragraph (e)(4)(i) of this section applies to taxable years ending on or after November 2, 2020.

[T.D. 7456, 42 FR 1195, Jan. 6, 1977]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.861-8, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.govinfo.gov.

§ 1.861-8T Computation of taxable income from sources within the United States and from other sources and activities (temporary).

(a) *In general*. (1) [Reserved]

(2) *Allocation and apportionment of deductions in general.* If an affiliated group of corporations joins in filing a consolidated return under section 1501, the provisions of this section are to be applied separately to each member in that affiliated group for purposes of determining such member's taxable income, except to the extent that expenses, losses, and other deductions are allocated and apportioned as if all domestic members of an affiliated group were a single corporation under section 864(e) and the regulations thereunder. See § 1.861-9T through § 1.861-11T for rules regarding the affiliated group allocation and apportionment of interest expense, and § 1.861-14T for rules regarding the affiliated group allocation and apportionment of expenses other than interest.

(a)(3)-(b) [Reserved] For further guidance, see § 1.861-8(a)(3) through (b).

(c) *Apportionment of deductions—(1) Deductions definitely related to a class of gross income.* Where a deduction has been allocated in accordance with paragraph (b) of this section to a class of gross income which is included in one statutory grouping and the residual grouping, the deduction must be apportioned between the statutory grouping and the residual grouping. Where a deduction has been allocated to a class of gross income which is included in more than one statutory grouping, such deduction must be apportioned among the statutory groupings and, where necessary, the residual grouping. Thus, in determining the separate limitations on the foreign tax credit imposed by section 904(d)(1) or by section 907, the income within a separate limitation category constitutes a statutory grouping of income and all other income not within that separate limitation category (whether domestic or within a different separate limitation category) constitutes the residual grouping. In this regard, the same method of apportionment must be used in apportioning a deduction to each separate limitation category. Also, see paragraph (f)(1)(iii) of this section with respect to the apportionment of deductions among the statutory groupings designated in section 904(d)(1). If the class of gross income to which a deduction has been allocated

consists entirely of a single statutory grouping or the residual grouping, there is no need to apportion that deduction. If a deduction is not definitely related to any gross income, it must be apportioned ratably as provided in paragraph (c)(3) of this section. A deduction is apportioned by attributing the deduction to gross income (within the class to which the deduction has been allocated) which is in one or more statutory groupings and to gross income (within the class) which is in the residual grouping. Such attribution must be accomplished in a manner which reflects to a reasonably close extent the factual relationship between the deduction and the grouping of gross income. In apportioning deductions, it may be that for the taxable year there is no gross income in the statutory grouping or that deductions will exceed the amount of gross income in the statutory grouping. See paragraph (d)(1) of this section with respect to cases in which deductions exceed gross income. In determining the method of apportionment for a specific deduction, examples of bases and factors which should be considered include, but are not limited to—

- (i) Comparison of units sold,
- (ii) Comparison of the amount of gross sales or receipts,
- (iii) Comparison of costs of goods sold,
- (iv) Comparison of profit contribution,
- (v) Comparison of expenses incurred, assets used, salaries paid, space utilized, and time spent which are attributable to the activities or properties giving rise to the class of gross income, and
- (iv) Comparison of the amount of gross income.

Paragraph (e) (2) through (8) of this section provides the applicable rules for allocation and apportionment of deductions for interest, research and development expenses, and certain other deductions. The effects on tax liability of the apportionment of deductions and the burden of maintaining records not otherwise maintained and making computations not otherwise made shall

be taken into consideration in determining whether a method of apportionment and its application are sufficiently precise. A method of apportionment described in this paragraph (c)(1) may not be used when it does not reflect, to a reasonably close extent, the factual relationship between the deduction and the groupings of income. Furthermore, certain methods of apportionment described in this paragraph (c)(1) may not be used in connection with any deduction for which another method is prescribed. The principles set forth above are applicable in apportioning both deductions definitely related to a class which constitutes less than all of the taxpayer's gross income and to deductions related to all of the taxpayer's gross income. If a deduction is not related to any class of gross income, it must be apportioned ratably as provided in paragraph (c)(3) of this section.

(2) *Apportionment based on assets.* For further guidance, see § 1.861-8(c)(2).

(3) [Reserved]

(d) *Excess of deductions and excluded and eliminated items of income.* (1) [Reserved]

(2) *Allocation and apportionment to exempt, excluded or eliminated income—(i) In general.* In the case of taxable years beginning after December 31, 1986, except to the extent otherwise permitted by § 1.861-13T, the following rules shall apply to take account of income that is exempt or excluded, or assets generating such income, with respect to allocation and apportionment of deductions.

(A) *Allocation of deductions.* In allocating deductions that are definitely related to one or more classes of gross income, exempt income (as defined in paragraph (d)(2)(ii) of this section) shall be taken into account.

(B) *Apportionment of deductions.* In apportioning deductions that are definitely related either to a class of gross income consisting of multiple groupings of income (whether statutory or residual) or to all gross income, exempt income and exempt assets (as defined in paragraph (d)(2)(ii) of this section) shall not be taken into account.

For purposes of apportioning deductions which are not taken into account

under § 1.1502-13 in determining gain or loss from intercompany transactions, as defined in § 1.1502-13, income from such transactions shall be taken into account in the year such income is ultimately included in gross income.

(ii) *Exempt income and exempt asset defined—(A) In general.* For further guidance, see § 1.861-8(d)(2)(ii)(A).

(B) *Certain stock and dividends.* For further guidance, see § 1.861-8(d)(2)(ii)(B).

(C) *Foreign-derived intangible income and inclusions under section 951A(a).* For further guidance, see § 1.861-8(d)(2)(ii)(C).

(iii) *Income that is not considered tax exempt.* The following items are not considered to be exempt, eliminated, or excluded income and, thus, may have expenses, losses, or other deductions allocated and apportioned to them:

(A) In the case of a foreign taxpayer (including a foreign sales corporation (FSC)) computing its effectively connected income, gross income (whether domestic or foreign source) which is not effectively connected to the conduct of a United States trade or business;

(B) In computing the combined taxable income of a DISC or FSC and its related supplier, the gross income of a DISC or a FSC; and

(C) For further guidance, see § 1.861-8(d)(2)(iii)(C) through (E).

(D)–(E) [Reserved]

(iv) *Value of stock attributable to previously taxed earnings and profits.* For further guidance, see § 1.861-8(d)(2)(iv).

(e) *Allocation and apportionment of certain deductions.* (1) [Reserved]. For further guidance, see § 1.861-8(e)(1).

(2) *Interest.* The rules concerning the allocation and apportionment of interest expense and certain interest equivalents are set forth in §§ 1.861-9T through § 1.861-13T.

(3) *Research and experimental expenditures.* For further guidance, see § 1.861-8(e)(3) through (15).

(4)–(15) [Reserved]

(f) *Miscellaneous matters.* For further guidance, see § 1.861-8(f) through (g).

(g) [Reserved]

(h) *Effective/applicability date.* (1) Paragraphs (f)(1)(vi)(E), (f)(1)(vi)(F), and (f)(1)(vi)(G) of this section apply to taxable years ending after April 9, 2008.

(2) Paragraph (e)(4), the last sentence of paragraph (f)(4)(i), and paragraph (g), *Examples 17, 18, and 30* of this section apply to taxable years beginning after July 31, 2009.

(3) Also, *see* paragraph (e)(12)(iv) of this section and 1.861-14(e)(6) for rules concerning the allocation and apportionment of deductions for charitable contributions.

[T.D. 8228, 53 FR 35474, Sept. 14, 1988]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.861-8T, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.govinfo.gov.

§ 1.861-9 Allocation and apportionment of interest expense and rules for asset-based apportionment.

(a) *In general.* For further guidance, see § 1.861-9T(a).

(b) *Interest equivalent*—(1) *Certain expenses and losses*—(i) *General rule.* Any expense or loss (to the extent deductible) incurred in a transaction or series of integrated or related transactions in which the taxpayer secures the use of funds for a period of time is subject to allocation and apportionment under the rules of this section and § 1.861-9T(b) if such expense or loss is substantially incurred in consideration of the time value of money. However, the allocation and apportionment of a loss under this paragraph (b) and § 1.861-9T(b) does not affect the characterization of such loss as capital or ordinary for any purpose other than for purposes of the section 861 regulations (as defined in § 1.861-8(a)(1)).

(ii) *Examples.* For further guidance, see § 1.861-9T(b)(1)(ii).

(2) *Certain foreign currency borrowings.* For further guidance, see § 1.861-9T(b)(2) through (7).

(3)–(7) [Reserved]

(8) *Guaranteed payments.* Any deductions for guaranteed payments for the use of capital under section 707(c) are allocated and apportioned in the same manner as interest expense.

(c) *Allowable deductions.* For further guidance, see § 1.861-9T(c) introductory text.

(1) *Disallowed deductions.* For further guidance, see § 1.861-9T(c)(1) through (4).

(2)–(4) [Reserved]

(5) *Section 163(j).* If a taxpayer is subject to section 163(j), the taxpayer's deduction for business interest expense is limited to the sum of the taxpayer's business interest income, 30 percent of the taxpayer's adjusted taxable income for the taxable year, and the taxpayer's floor plan financing interest expense. In the taxable year that any deduction is permitted for business interest expense with respect to a disallowed business interest carryforward, that business interest expense is apportioned for purposes of this section under rules set forth in paragraph (d), (e), or (f) of this section (as applicable) as though it were incurred in the taxable year in which the expense is deducted.

(d) *Apportionment rules for individuals, estates, and certain trusts.* For further guidance, see § 1.861-9T(d).

(e) *Partnerships*—(1) *In general—aggregate rule.* For further guidance, see § 1.861-9T(e)(1).

(2) *Corporate partners whose interest in the partnership is 10 percent or more.* A corporate partner shall apportion its interest expense, including the partner's distributive share of partnership interest expense, by reference to the partner's assets, including the partner's pro rata share of partnership assets, under the rules of paragraph (f) of this section if the corporate partner's direct and indirect interest in the partnership (as determined under the attribution rules of section 318) is 10 percent or more. A corporation using the tax book value method or alternative tax book value method of apportionment shall use the partnership's inside basis in its assets, including adjustments under sections 734(b) and 743(b), if any, and adjusted to the extent required under § 1.861-10T(d)(2).

(3) *Individual partners who are general partners or who are limited partners with an interest in the partnership of 10 percent or more.* An individual partner is subject to the rules of this paragraph (e)(3) if either the individual is a general partner or the individual's direct and indirect interest (as determined under the attribution rules of section 318) in the partnership is 10 percent or more. The individual shall first classify his or her distributive share of partnership interest expense as interest incurred in the active conduct of a trade