and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

REPORT ON POSSESSIONS CORPORATIONS

For provisions requiring the Secretary of the Treasury to submit a report to Congress respecting the operation and effect of subsec. (b) of this section for the year 1981 and each second calendar year thereafter, see section 441(a) of Pub. L. 98–369, set out as a note under section 936 of this title.

[§ 934A. Repealed. Pub. L. 99–514, title XII, § 1275(c)(3), Oct. 22, 1986, 100 Stat. 2599]

Section, added Pub. L. 97–455, § 1(a), Jan. 12, 1983, 96 Stat. 2497, related to income tax rate on Virgin Islands source income.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 1277 of Pub. L. 99–514, set out as an Effective Date of 1986 Amendment note under section 931 of this title.

[§ 935. Repealed. Pub. L. 99–514, title XII, § 1272(d)(2), Oct. 22, 1986, 100 Stat. 2594]

Section, added Pub. L. 92–606, § 1(a), Oct. 31, 1972, 86 Stat. 1494; amended Pub. L. 108–357, title VIII, § 908(c)(4), Oct. 22, 2004, 118 Stat. 1656, related to coordination of United States and Guam individual income taxes.

AMENDMENT SUBSEQUENT TO REPEAL

Pub. L. 108–357, title IX, § 908(c)(4), (d), Oct. 22, 2004, 118 Stat. 1656, 1657, applicable to taxable years ending after Oct. 22, 2004, amended section, as in effect before the effective date of its repeal, in introductory provisions of subsec. (a), by substituting ''who, during the entire taxable year'' for ''for the taxable year who'', in subsecs. (a)(1) and (b)(1)(B), by inserting ''bona fide'' before ''resident'', in subsec. (b)(1)(A), by inserting ''(other a bona fide resident of Guam during the entire taxable year)'' after ''United States'', and, in subsection (b)(2), by striking out ''residence and'' before ''citizenship''.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 1277 of Pub. L. 99–514, set out as an Effective Date of 1986 Amendment note under section 931 of this title.

§ 936. Puerto Rico and possession tax credit

(a) Allowance of credit

(1) In general

Except as otherwise provided in this section, if a domestic corporation elects the application of this section and if the conditions of both subparagraph (A) and subparagraph (B) of paragraph (2) are satisfied, there shall be allowed as a credit against the tax imposed by this chapter an amount equal to the portion of the tax which is attributable to the sum of—

(A) the taxable income, from sources without the United States, from—

(i) the active conduct of a trade or business within a possession of the United States, or

(ii) the sale or exchange of substantially all of the assets used by the taxpayer in the active conduct of such trade or business, and

(B) the qualified possession source investment income.

(2) Conditions which must be satisfied

The conditions referred to in paragraph (1) are:

(A) 3-year period

If 80 percent or more of the gross income of such domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States (determined without regard to subsections (f) and (g) of section 904); and

(B) Trade or business

If 75 percent or more of the gross income of such domestic corporation for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States.

(3) Credit not allowed against certain taxes

The credit provided by paragraph (1) shall not be allowed against the tax imposed by—

(A) section 59A (relating to environmental tax),

(B) section 531 (relating to the tax on accumulated earnings),

(C) section 541 (relating to personal holding company tax), or

(D) section 1351 (relating to recoveries of foreign expropriation losses).

(4) Limitations on credit for active business income

(A) In general

The amount of the credit determined under paragraph (1) for any taxable year with respect to income referred to in subparagraph (A) thereof shall not exceed the sum of the following amounts:

(i) 60 percent of the sum of—

(I) the aggregate amount of the possession corporation's qualified possession wages for such taxable year, plus

(II) the allocable employee fringe benefit expenses of the possession corporation for the taxable year.

(ii) The sum of—

(I) 15 percent of the depreciation allowances for the taxable year with respect to short-life qualified tangible property,

(II) 40 percent of the depreciation allowances for the taxable year with respect to medium-life qualified tangible property, and

(III) 65 percent of the depreciation allowances for the taxable year with respect to long-life qualified tangible property.

(iii) If the possession corporation does not have an election to use the method described in subsection (h)(5)(C)(ii) (relating to profit split) in effect for the taxable year, the amount of qualified possession

income taxes for the taxable year allocable to nonsheltered income.

(B) Election to take reduced credit

(i) In general

If an election under this subparagraph applies to a possession corporation for any taxable year—

(I) subparagraph (A), and the provisions of subsection (i), shall not apply to such possession corporation for such taxable year, and

(II) the credit determined under paragraph (1) for such taxable year with respect to income referred to in subparagraph (A) thereof shall be the applicable percentage of the credit which would otherwise have been determined under such paragraph with respect to such income.

Notwithstanding subclause (I), a possession corporation to which an election under this subparagraph applies shall be entitled to the benefits of subsection (i)(3)(B) for taxes allocable (on a pro rata basis) to taxable income the tax on which is not offset by reason of this subparagraph.

(ii) Applicable percentage

The term ''applicable percentage'' means the percentage determined in accordance with the following table:

In the case of taxable years beginning in:	The percentage is:
1994	60
1995	55
1996	50
1997	45
1998 and thereafter	40.

(iii) Election

(I) In general

An election under this subparagraph by any possession corporation may be made only for the corporation's first taxable year beginning after December 31, 1993, for which it is a possession corporation.

(II) Period of election

An election under this subparagraph shall apply to the taxable year for which made and all subsequent taxable years unless revoked.

(III) Affiliated groups

If, for any taxable year, an election is not in effect for any possession corporation which is a member of an affiliated group, any election under this subparagraph for any other member of such group is revoked for such taxable year and all subsequent taxable years. For purposes of this subclause, members of an affiliated group shall be determined without regard to the exceptions contained in section 1504(b) and as if the constructive ownership rules of section 1563(e) applied for purposes of section 1504(a). The Secretary may prescribe regulations to prevent the avoidance of this subclause through deconsolidation or otherwise.

(C) Cross reference

For definitions and special rules applicable to this paragraph, see subsection (i).

(b) Amounts received in United States

In determining taxable income for purposes of subsection (a), there shall not be taken into account as income from sources without the United States any gross income which was received by such domestic corporation within the United States, whether derived from sources within or without the United States. This subsection shall not apply to any amount described in subsection (a)(1)(A)(i) received from a person who is not a related person (within the meaning of subsection (h)(3) but without regard to subparagraphs (D)(ii) and (E)(i) thereof) with respect to the domestic corporation.

(c) Treatment of certain foreign taxes

For purposes of this title, any tax of a foreign country or a possession of the United States which is paid or accrued with respect to taxable income which is taken into account in computing the credit under subsection (a) shall not be treated as income, war profits, or excess profits taxes paid or accrued to a foreign country or possession of the United States, and no deduction shall be allowed under this title with respect to any amounts so paid or accrued.

(d) Definitions and special rules

For purposes of this section—

(1) Possession

The term ''possession of the United States'' includes the Commonwealth of Puerto Rico and the Virgin Islands.

(2) Qualified possession source investment income

The term ''qualified possession source investment income'' means gross income which—

(A) is from sources within a possession of the United States in which a trade or business is actively conducted, and

(B) the taxpayer establishes to the satisfaction of the Secretary is attributable to the investment in such possession (for use therein) of funds derived from the active conduct of a trade or business in such possession, or from such investment,

less the deductions properly apportioned or allocated thereto.

(3) Carryover basis property

(A) In general

Income from the sale or exchange of any asset the basis of which is determined in whole or in part by reference to its basis in the hands of another person shall not be treated as income described in subparagraph (A) or (B) of subsection (a)(1).

(B) Exception for possessions corporations, etc.

For purposes of subparagraph (A), the holding of any asset by another person shall

not be taken into account if throughout the period for which such asset was held by such person section 931, this section, or section 957(c) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applied to such person.

(4) Investment in qualified Caribbean Basin countries

(A) In general

For purposes of paragraph (2)(B), an investment in a financial institution shall, subject to such conditions as the Secretary may prescribe by regulations, be treated as for use in Puerto Rico to the extent used by such financial institution (or by the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank)—

(i) for investment, consistent with the goals and purposes of the Caribbean Basin Economic Recovery Act, in—

(I) active business assets in a qualified Caribbean Basin country, or

(II) development projects in a qualified Caribbean Basin country, and

(ii) in accordance with a specific authorization granted by the Commissioner of Financial Institutions of Puerto Rico pursuant to regulations issued by such Commissioner.

A similar rule shall apply in the case of a direct investment in the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank.

(B) Qualified Caribbean Basin country

For purposes of this subsection, the term ''qualified Caribbean Basin country'' means any beneficiary country (within the meaning of section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act) which meets the requirements of clauses (i) and (ii) of section 274(h)(6)(A) and the Virgin Islands.

(C) Additional requirements

Subparagraph (A) shall not apply to any investment made by a financial institution (or by the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank) unless—

(i) the person in whose trade or business such investment is made (or such other recipient of the investment) and the financial institution or such Bank certify to the Secretary and the Commissioner of Financial Institutions of Puerto Rico that the proceeds of the loan will be promptly used to acquire active business assets or to make other authorized expenditures, and

(ii) the financial institution (or the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank) and the recipient of the investment funds agree to permit the Secretary and the Commissioner of Financial Institutions of Puerto Rico to examine such of their books and records as may be necessary to ensure that the requirements of this paragraph are met.

(D) Requirement for investment in Caribbean Basin countries

(i) In general

For each calendar year, the government of Puerto Rico shall take such steps as may be necessary to ensure that at least $100,000,000 of qualified Caribbean Basin country investments are made during such calendar year.

(ii) Qualified Caribbean Basin country investment

For purposes of clause (i), the term ''qualified Caribbean Basin country investment'' means any investment if—

(I) the income from such investment is treated as qualified possession source investment income by reason of subparagraph (A), and

(II) such investment is not (directly or indirectly) a refinancing of a prior investment (whether or not such prior investment was a qualified Caribbean Basin country investment).

(e) Election

(1) Period of election

The election provided in subsection (a) shall be made at such time and in such manner as the Secretary may by regulations prescribe. Any such election shall apply to the first taxable year for which such election was made and for which the domestic corporation satisfied the conditions of subparagraphs (A) and (B) of subsection (a)(2) and for each taxable year thereafter until such election is revoked by the domestic corporation under paragraph (2). If any such election is revoked by the domestic corporation under paragraph (2), such domestic corporation may make a subsequent election under subsection (a) for any taxable year thereafter for which such domestic corporation satisfies the conditions of subparagraphs (A) and (B) of subsection (a)(2) and any such subsequent election shall remain in effect until revoked by such domestic corporation under paragraph (2).

(2) Revocation

An election under subsection (a)—

(A) may be revoked for any taxable year beginning before the expiration of the 9th taxable year following the taxable year for which such election first applies only with the consent of the Secretary; and

(B) may be revoked for any taxable year beginning after the expiration of such 9th taxable year without the consent of the Secretary.

(f) Limitation on credit for DISC's and FSC's

No credit shall be allowed under this section to a corporation for any taxable year—

(1) for which it is a DISC or former DISC, or

(2) in which it owns at any time stock in a—

(A) DISC or former DISC, or

(B) FSC or former FSC.

(g) Exception to accumulated earnings tax

(1) For purposes of section 535, the term ''accumulated taxable income'' shall not include taxable income entitled to the credit under subsection (a).

(2) For purposes of section 537, the term ''reasonable needs of the business'' includes assets which produce income eligible for the credit under subsection (a).

(h) Tax treatment of intangible property income

(1) In general

(A) Income attributable to shareholders

The intangible property income of a corporation electing the application of this section for any taxable year shall be included on a pro rata basis in the gross income of all shareholders of such electing corporation at the close of the taxable year of such electing corporation as income from sources within the United States for the taxable year of such shareholder in which or with which the taxable year of such electing corporation ends.

(B) Exclusion from the income of an electing corporation

Any intangible property income of a corporation electing the application of this section which is included in the gross income of a shareholder of such corporation by reason of subparagraph (A) shall be excluded from the gross income of such corporation.

(2) Foreign shareholders; shareholders not subject to tax

(A) In general

Paragraph (1)(A) shall not apply with respect to any shareholder—

(i) who is not a United States person, or

(ii) who is not subject to tax under this title on intangible property income which would be allocated to such shareholder (but for this subparagraph).

(B) Treatment of nonallocated intangible property income

For purposes of this subtitle, intangible property income of a corporation electing the application of this section which is not included in the gross income of a shareholder of such corporation by reason of subparagraph (A)—

(i) shall be treated as income from sources within the United States, and

(ii) shall not be taken into account under subsection (a)(2).

(3) Intangible property income

For purposes of this subsection—

(A) In general

The term ''intangible property income'' means the gross income of a corporation attributable to any intangible property other than intangible property which has been licensed to such corporation since prior to 1948 and is in use by such corporation on the date of the enactment of this subparagraph.

(B) Intangible property

The term ''intangible property'' means any—

(i) patent, invention, formula, process, design, pattern, or know-how;

(ii) copyright, literary, musical, or artistic composition;

(iii) trademark, trade name, or brand name;

(iv) franchise, license, or contract;

(v) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; or

(vi) any similar item,

which has substantial value independent of the services of any individual.

(C) Exclusion of reasonable profit

The term ''intangible property income'' shall not include any portion of the income from the sale, exchange or other disposition of any product, or from the rendering of services, by a corporation electing the application of this section which is determined by the Secretary to be a reasonable profit on the direct and indirect costs incurred by such electing corporation which are attributable to such income.

(D) Related person

(i) In general

A person (hereinafter referred to as the ''related person'') is related to any person if—

(I) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

(II) the related person and such person are members of the same controlled group of corporations.

(ii) Special rule

For purposes of clause (i), section 267(b) and section 707(b)(1) shall be applied by substituting ''10 percent'' for ''50 percent''.

(E) Controlled group of corporations

The term ''controlled group of corporations'' has the meaning given to such term by section 1563(a), except that—

(i) ''more than 10 percent'' shall be substituted for ''at least 80 percent'' and ''more than 50 percent'' each place either appears in section 1563(a), and

(ii) the determination shall be made without regard to subsections (a)(4), (b)(2), and (e)(3)(C) of section 1563.

(4) Distributions to meet qualification requirements

(A) In general

If the Secretary determines that a corporation does not satisfy a condition specified in subparagraph (A) or (B) of subsection (a)(2) for any taxable year by reason of the exclusion from gross income under paragraph (1)(B), such corporation shall nevertheless be treated as satisfying such condition for such year if it makes a pro rata distribution of property after the close of such taxable year to its shareholders (designated at the time of such distribution as a distribution to meet qualification requirements) with respect to their stock in an amount which is equal to—

(i) if the condition of subsection (a)(2)(A) is not satisfied, that portion of the gross income for the period described in subsection (a)(2)(A)—

(I) which was not derived from sources within a possession, and

(II) which exceeds the amount of such income for such period which would enable such corporation to satisfy the condition of subsection (a)(2)(A),

(ii) if the condition of subsection (a)(2)(B) is not satisfied, that portion of the gross income for such period—

(I) which was not derived from the active conduct of a trade or business within a possession, and

(II) which exceeds the amount of such income for such period which would enable such corporation to satisfy the conditions of subsection (a)(2)(B), or

(iii) if neither of such conditions is satisfied, that portion of the gross income which exceeds the amount of gross income for such period which would enable such corporation to satisfy the conditions of subparagraphs (A) and (B) of subsection (a)(2).

(B) Effectively connected income

In the case of a shareholder who is a nonresident alien individual or a foreign corporation, trust, or estate, any distribution described in subparagraph (A) shall be treated as income which is effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States.

(C) Distribution denied in case of fraud or willful neglect

Subparagraph (A) shall not apply to a corporation if the determination of the Secretary described in subparagraph (A) contains a finding that the failure of such corporation to satisfy the conditions in subsection (a)(2) was due in whole or in part to fraud with intent to evade tax or willful neglect on the part of such corporation.

(5) Election out

(A) In general

The rules contained in paragraphs (1) through (4) do not apply for any taxable year if an election pursuant to subparagraph (F) is in effect to use one of the methods specified in subparagraph (C).

(B) Eligibility

(i) Requirement of significant business presence

An election may be made to use one of the methods specified in subparagraph (C) with respect to a product or type of service only if an electing corporation has a significant business presence in a possession with respect to such product or type of service. An election may remain in effect with respect to such product or type of service for any subsequent taxable year only if such electing corporation maintains a significant business presence in a possession with respect to such product or type of service in such subsequent taxable year. If an election is not in effect for a taxable year because of the preceding sentence, the electing corporation shall be deemed to have revoked the election on the first day of such taxable year.

(ii) Definition

For purposes of this subparagraph, an electing corporation has a ''significant business presence'' in a possession for a taxable year with respect to a product or type of service if:

(I) the total production costs (other than direct material costs and other than interest excluded by regulations prescribed by the Secretary) incurred by the electing corporation in the possession in producing units of that product sold or otherwise disposed of during the taxable year by the affiliated group to persons who are not members of the affiliated group are not less than 25 percent of the difference between (a) the gross receipts from sales or other dispositions during the taxable year by the affiliated group to persons who are not members of the affiliated group of such units of the product produced, in whole or in part, by the electing corporation in the possession, and (b) the direct material costs of the purchase of materials for such units of that product by all members of the affiliated group from persons who are not members of the affiliated group; or

(II) no less than 65 percent of the direct labor costs of the affiliated group for units of the product produced during the taxable year in whole or in part by the electing corporation or for the type of service rendered by the electing corporation during the taxable year, is incurred by the electing corporation and is compensation for services performed in the possession; or

(III) with respect to purchases and sales by an electing corporation of all goods not produced in whole or in part by any member of the affiliated group and sold by the electing corporation to persons other than members of the affiliated group, no less than 65 percent of the total direct labor costs of the affiliated group in connection with all purchases and sales of such goods sold during the taxable year by such electing corporation is incurred by such electing corporation and is compensation for services performed in the possession.

Notwithstanding satisfaction of one of the foregoing tests, an electing corporation shall not be treated as having a significant business presence in a possession with respect to a product produced in whole or in part by the electing corporation in the possession, for purposes of an election to use the method specified in subparagraph (C)(ii), unless such product is manufactured or produced in the possession by the electing corporation within the meaning of subsection (d)(1)(A) of section 954.

(iii) Special rules

(I) An electing corporation which produces a product or renders a type of service in a possession on the date of the enactment of this clause is not required to meet the significant business presence test in a possession with respect to such product or type of service for its taxable years beginning before January 1, 1986.

(II) For purposes of this subparagraph, the costs incurred by an electing corporation or any other member of the affiliated group in connection with contract manufacturing by a person other than a member of the affiliated group, or in connection with a similar arrangement thereto, shall be treated as direct labor costs of the affiliated group and shall not be treated as production costs incurred by the electing corporation in the possession or as direct material costs or as compensation for services performed in the possession, except to the extent as may be otherwise provided in regulations prescribed by the Secretary.

(iv) Regulations

The Secretary may prescribe regulations setting forth:

(I) an appropriate transitional (but not in excess of three taxable years) significant business presence test for commencement in a possession of operations with respect to products or types of service after the date of the enactment of this clause and not described in subparagraph (B)(iii)(I),

(II) a significant business presence test for other appropriate cases, consistent with the tests specified in subparagraph (B)(ii),

(III) rules for the definition of a product or type of service, and

(IV) rules for treating components produced in whole or in part by a related person as materials, and the costs (including direct labor costs) related thereto as a cost of materials, where there is an independent resale price for such components or where otherwise consistent with the intent of the substantial business presence tests.

(C) Methods of computation of taxable income

If an election of one of the following methods is in effect pursuant to subparagraph (F) with respect to a product or type of service, an electing corporation shall compute its income derived from the active conduct of a trade or business in a possession with respect to such product or type of service in accordance with the method which is elected.

(i) Cost sharing

(I) Payment of cost sharing

If an election of this method is in effect, the electing corporation must make a payment for its share of the cost (if any) of product area research which is paid or accrued by the affiliated group during that taxable year. Such share shall not be less than the same proportion of 110 percent of the cost of such product area research which the amount of ''possession sales'' bears to the amount of ''total sales'' of the affiliated group. The cost of product area research paid or accrued solely by the electing corporation in a taxable year (excluding amounts paid directly or indirectly to or on behalf of related persons and excluding amounts paid under any cost sharing agreements with related persons) will reduce (but not below zero) the amount of the electing corporation's cost sharing payment under this method for that year. In the case of intangible property described in subsection (h)(3)(B)(i) which the electing corporation is treated as owning under subclause (II), in no event shall the payment required under this subclause be less than the inclusion or payment which would be required under section 367(d)(2)(A)(ii) or section 482 if the electing corporation were a foreign corporation.

(a) Product area research

For purposes of this section, the term ''product area research'' includes (notwithstanding any provision to the contrary) the research, development and experimental costs, losses, expenses and other related deductions—including amounts paid or accrued for the performance of research or similar activities by another person; qualified research expenses within the meaning of section 41(b); amounts paid or accrued for the use of, or the right to use, research or any of the items specified in subsection (h)(3)(B)(i); and a proper allowance for amounts incurred for the acquisition of any of the items specified in subsection (h)(3)(B)(i)—which are properly apportioned or allocated to the same product area as that in which the electing corporation conducts its activities, and a ratable part of any such costs, losses, expenses and other deductions which cannot definitely be allocated to a particular product area.

(b) Affiliated group

For purposes of this subsection, the term ''affiliated group'' shall mean the electing corporation and all other organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, within the meaning of section 482.

(c) Possession sales

For purposes of this section, the term ''possession sales'' means the aggregate sales or other dispositions for the taxable year to persons who are

not members of the affiliated group by members of the affiliated group of products produced, in whole or in part, by the electing corporation in the possession which are in the same product area as is used for determining the amount of product area research, and of services rendered, in whole or in part, in the possession in such product area to persons who are not members of the affiliated group.

(d) Total sales

For purposes of this section, the term ''total sales'' means the aggregate sales or other dispositions for the taxable year to persons who are not members of the affiliated group by members of the affiliated group of all products in the same product area as is used for determining the amount of product area research, and of services rendered in such product area to persons who are not members of the affiliated group.

(e) Product area

For purposes of this section, the term ''product area'' shall be defined by reference to the three-digit classification of the Standard Industrial Classification code. The Secretary may provide for the aggregation of two or more three-digit classifications where appropriate, and for a classification system other than the Standard Industrial Classification code in appropriate cases.

(II) Effect of election

For purposes of determining the amount of its gross income derived from the active conduct of a trade or business in a possession with respect to a product produced by, or type of service rendered by, the electing corporation for a taxable year, if an election of this method is in effect, the electing corporation shall be treated as the owner (for purposes of obtaining a return thereon) of intangible property described in subsection (h)(3)(B)(i) which is related to the units of the product produced, or type of service rendered, by the electing corporation. Such electing corporation shall not be treated as the owner (for purposes of obtaining a return thereon) of any intangible property described in subsection (h)(3)(B)(ii) through (v) (to the extent not described in subsection (h)(3)(B)(i)) or of any other nonmanufacturing intangible. Notwithstanding the preceding sentence, an electing corporation shall be treated as the owner (for purposes of obtaining a return thereon) of (a) intangible property which was developed solely by such corporation in a possession and is owned by such corporation, (b) intangible property described in subsection (h)(3)(B)(i) acquired by such corporation from a person who was not related to such corporation (or to any person related to such corporation) at the time of, or in connection with, such acquisition, and (c) any intangible property described in subsection (h)(3)(B)(ii) through (v) (to the extent not described in subsection (h)(3)(B)(i)) and other nonmanufacturing intangibles which relate to sales of units of products, or services rendered, to unrelated persons for ultimate consumption or use in the possession in which the electing corporation conducts its trade or business.

(III) Payment provisions

(a) The cost sharing payment determined under subparagraph (C)(i)(I) for any taxable year shall be made to the person or persons specified in subparagraph (C)(i)(IV)(a) not later than the time prescribed by law for filing the electing corporation's return for such taxable year (including any extensions thereof). If all or part of such payment is not timely made, the amount of the cost sharing payment required to be paid shall be increased by the amount of interest that would have been due under section 6601(a) had the portion of the cost sharing payment that is not timely made been an amount of tax imposed by this title and had the last date prescribed for payment been the due date of the electing corporations[1] return (determined without regard to any extension thereof). The amount by which a cost sharing payment determined under subparagraph (C)(i)(I) is increased by reason of the preceding sentence shall not be treated as a cost sharing payment or as interest. If failure to make timely payment is due in whole or in part to fraud or willful neglect, the electing corporation shall be deemed to have revoked the election made under subparagraph (A) on the first day of the taxable year for which the cost sharing payment was required.

(b) For purposes of this title, any tax of a foreign country or possession of the United States which is paid or accrued with respect to the payment or receipt of a cost sharing payment determined under subparagraph (C)(i)(I) or of an amount of increase referred to in subparagraph (C)(i)(III)(a) shall not be treated as income, war profits, or excess profits taxes paid or accrued to a foreign country or possession of the United States, and no deduction shall be allowed under this title with respect to any amounts of such tax so paid or accrued.

(IV) Special rules

(a) The amount of the cost sharing payment determined under subparagraph (C)(i)(I), and any increase in the amount thereof in accordance with subparagraph (C)(i)(III)(a), shall not be treated as income of the recipient, but shall reduce

[1] So in original. Probably should be ''corporation's''.

the amount of the deductions (and the amount of reductions in earnings and profits) otherwise allowable to the appropriate domestic member or members (other than an electing corporation) of the affiliated group, or, if there is no such domestic member, to the foreign member or members of such affiliated group as the Secretary may provide under regulations.

(b) If an election of this method is in effect, the electing corporation shall determine its intercompany pricing under the appropriate section 482 method, provided, however, that an electing corporation shall not be denied use of the resale price method for purposes of such intercompany pricing merely because the reseller adds more than an insubstantial amount to the value of the product by the use of intangible property.

(c) The amount of qualified research expenses, within the meaning of section 41, of any member of the controlled group of corporations (as defined in section 41(f)) of which the electing corporation is a member shall not be affected by the cost sharing payment required under this method.

(ii) Profit split

(I) General rule

If an election of this method is in effect, the electing corporation's taxable income derived from the active conduct of a trade or business in a possession with respect to units of a product produced or type of service rendered, in whole or in part, by the electing corporation shall be equal to 50 percent of the combined taxable income of the affiliated group (other than foreign affiliates) derived from covered sales of units of the product produced or type of service rendered, in whole or in part, by the electing corporation in a possession.

(II) Computation of combined taxable income

Combined taxable income shall be computed separately for each product produced or type of service rendered, in whole or in part, by the electing corporation in a possession. Combined taxable income shall be computed (notwithstanding any provision to the contrary) for each such product or type of service rendered by deducting from the gross income of the affiliated group (other than foreign affiliates) derived from covered sales of such product or type of service all expenses, losses, and other deductions properly apportioned or allocated to gross income from such sales or services, and a ratable part of all expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income, which are incurred by the affiliated group (other than foreign affiliates). Notwithstanding any other provision to the contrary, in computing the combined taxable income for each such product or type of service rendered, the research, development, and experimental costs, expenses and related deductions for the taxable year which would otherwise be apportioned or allocated to the gross income of the affiliated group (other than foreign affiliates) derived from covered sales of such product produced or type of service rendered, in whole or in part, by the electing corporation in a possession, shall not be less than the same proportion of the amount of the share of product area research determined under subparagraph (C)(i)(I) (without regard to the third and fourth sentences thereof, but substituting ''120 percent'' for ''110 percent'' in the second sentence thereof) in the product area which includes such product or type of service, that such gross income from the product or type of service bears to such gross income from all products and types of services, within such product area, produced or rendered, in whole or part, by the electing corporation in a possession.

(III) Division of combined taxable income

50 percent of the combined taxable income computed as provided in subparagraph (C)(ii)(II) shall be allocated to the electing corporation. Combined taxable income, computed without regard to the last sentence of subparagraph (C)(ii)(II), less the amount allocated to the electing corporation under the preceding sentence, shall be allocated to the appropriate domestic member or members (other than any electing corporation) of the affiliated group and shall be treated as income from sources within the United States, or, if there is no such domestic member, to a foreign member or members of such affiliated group as the Secretary may provide under regulations.

(IV) Covered sales

For purposes of this paragraph, the term ''covered sales'' means sales by members of the affiliated group (other than foreign affiliates) to persons who are not members of the affiliated group or to foreign affiliates.

(D) Unrelated person

For purposes of this paragraph, the term ''unrelated person'' means any person other than a person related within the meaning of paragraph (3)(D) to the electing corporation.

(E) Electing corporation

For purposes of this subsection, the term ''electing corporation'' means a domestic corporation for which an election under this section is in effect.

(F) Time and manner of election; revocation

(i) In general

An election under subparagraph (A) to use one of the methods under subpara-

graph (C) shall be made only on or before the due date prescribed by law (including extensions) for filing the tax return of the electing corporation for its first taxable year beginning after December 31, 1982. If an election of one of such methods is made, such election shall be binding on the electing corporation and such method must be used for each taxable year thereafter until such election is revoked by the electing corporation under subparagraph (F)(iii). If any such election is revoked by the electing corporation under subparagraph (F)(iii), such electing corporation may make a subsequent election under subparagraph (A) only with the consent of the Secretary.

(ii) Manner of making election

An election under subparagraph (A) to use one of the methods under subparagraph (C) shall be made by filing a statement to such effect with the return referred to in subparagraph (F)(i) or in such other manner as the Secretary may prescribe by regulations.

(iii) Revocation

(I) Except as provided in subparagraph (F)(iii)(II), an election may be revoked for any taxable year only with the consent of the Secretary.

(II) An election shall be deemed revoked for the year in which the electing corporation is deemed to have revoked such election under subparagraph (B)(i) or (C)(i)(III)(a).

(iv) Aggregation

(I) Where more than one electing corporation in the affiliated group produces any product or renders any services in the same product area, all such electing corporations must elect to compute their taxable income under the same method under subparagraph (C).

(II) All electing corporations in the same affiliated group that produce any products or render any services in the same product area may elect, subject to such terms and conditions as the Secretary may prescribe by regulations, to compute their taxable income from export sales under a different method from that used for all other sales and services. For this purpose, export sales means all sales by the electing corporation of products to foreign persons for use or consumption outside the United States and its possessions, provided such products are manufactured or produced in the possession within the meaning of subsection (d)(1)(A) of section 954, and further provided (except to the extent otherwise provided by regulations) the income derived by such foreign person on resale of such products (in the same state or in an altered state) is not included in foreign base company income for purposes of section 954(a).

(III) All members of an affiliated group must consent to an election under this subsection at such time and in such manner as shall be prescribed by the Secretary by regulations.

(6) Treatment of certain sales made after July 1, 1982

(A) In general

For purposes of this section, in the case of a disposition of intangible property made by a corporation after July 1, 1982, any gain or loss from such disposition shall be treated as gain or loss from sources within the United States to which paragraph (5) does not apply.

(B) Exception

Subparagraph (A) shall not apply to any disposition by a corporation of intangible property if such disposition is to a person who is not a related person to such corporation.

(C) Paragraph does not affect eligibility

This paragraph shall not apply for purposes of determining whether the corporation meets the requirements of subsection (a)(2).

(7) Section 864(e)(1) not to apply

This subsection shall be applied as if section 864(e)(1) (relating to treatment of affiliated groups) had not been enacted.

(8) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including rules for the application of this subsection to income from leasing of products to unrelated persons.

(i) Definitions and special rules relating to limitations of subsection (a)(4)

(1) Qualified possession wages

For purposes of this section—

(A) In general

The term ''qualified possession wages'' means wages paid or incurred by the possession corporation during the taxable year in connection with the active conduct of a trade or business within a possession of the United States to any employee for services performed in such possession, but only if such services are performed while the principal place of employment of such employee is within such possession.

(B) Limitation on amount of wages taken into account

(i) In general

The amount of wages which may be taken into account under subparagraph (A) with respect to any employee for any taxable year shall not exceed 85 percent of the contribution and benefit base determined under section 230 of the Social Security Act for the calendar year in which such taxable year begins.

(ii) Treatment of part-time employees, etc.

If—

(I) any employee is not employed by the possession corporation on a substan-

tially full-time basis at all times during the taxable year, or

(II) the principal place of employment of any employee with the possession corporation is not within a possession at all times during the taxable year,

the limitation applicable under clause (i) with respect to such employee shall be the appropriate portion (as determined by the Secretary) of the limitation which would otherwise be in effect under clause (i).

(C) Treatment of certain employees

The term ''qualified possession wages'' shall not include any wages paid to employees who are assigned by the employer to perform services for another person, unless the principal trade or business of the employer is to make employees available for temporary periods to other persons in return for compensation. All possession corporations treated as 1 corporation under paragraph (5) shall be treated as 1 employer for purposes of the preceding sentence.

(D) Wages

(i) In general

Except as provided in clause (ii), the term ''wages'' has the meaning given to such term by subsection (b) of section 3306 (determined without regard to any dollar limitation contained in such section). For purposes of the preceding sentence, such subsection (b) shall be applied as if the term ''United States'' included all possessions of the United States.

(ii) Special rule for agricultural labor and railway labor

In any case to which subparagraph (A) or (B) of paragraph (1) of section 51(h) applies, the term ''wages'' has the meaning given to such term by section 51(h)(2).

(2) Allocable employee fringe benefit expenses

(A) In general

The allocable employee fringe benefit expenses of any possession corporation for any taxable year is an amount which bears the same ratio to the amount determined under subparagraph (B) for such taxable year as—

(i) the aggregate amount of the possession corporation's qualified possession wages for such taxable year, bears to

(ii) the aggregate amount of the wages paid or incurred by such possession corporation during such taxable year.

In no event shall the amount determined under the preceding sentence exceed 15 percent of the amount referred to in clause (i).

(B) Expenses taken into account

For purposes of subparagraph (A), the amount determined under this subparagraph for any taxable year is the aggregate amount allowable as a deduction under this chapter to the possession corporation for such taxable year with respect to—

(i) employer contributions under a stock bonus, pension, profit-sharing, or annuity plan,

(ii) employer-provided coverage under any accident or health plan for employees, and

(iii) the cost of life or disability insurance provided to employees.

Any amount treated as wages under paragraph (1)(D) shall not be taken into account under this subparagraph.

(3) Treatment of possession taxes

(A) Amount of credit for possession corporations not using profit split

(i) In general

For purposes of subsection (a)(4)(A)(iii), the amount of the qualified possession income taxes for any taxable year allocable to nonsheltered income shall be an amount which bears the same ratio to the possession income taxes for such taxable year as—

(I) the increase in the tax liability of the possession corporation under this chapter for the taxable year by reason of subsection (a)(4)(A) (without regard to clause (iii) thereof), bears to

(II) the tax liability of the possession corporation under this chapter for the taxable year determined without regard to the credit allowable under this section.

(ii) Limitation on amount of taxes taken into account

Possession income taxes shall not be taken into account under clause (i) for any taxable year to the extent that the amount of such taxes exceeds 9 percent of the amount of the taxable income for such taxable year.

(B) Deduction for possession corporations using profit split

Notwithstanding subsection (c), if a possession corporation is not described in subsection (a)(4)(A)(iii) for the taxable year, such possession corporation shall be allowed a deduction for such taxable year in an amount which bears the same ratio to the possession income taxes for such taxable year as—

(i) the increase in the tax liability of the possession corporation under this chapter for the taxable year by reason of subsection (a)(4)(A), bears to

(ii) the tax liability of the possession corporation under this chapter for the taxable year determined without regard to the credit allowable under this section.

In determining the credit under subsection (a) and in applying the preceding sentence, taxable income shall be determined without regard to the preceding sentence.

(C) Possession income taxes

For purposes of this paragraph, the term ''possession income taxes'' means any taxes of a possession of the United States which are treated as not being income, war profits, or excess profits taxes paid or accrued to a possession of the United States by reason of subsection (c).

(4) Depreciation rules

For purposes of this section—

(A) Depreciation allowances

The term ''depreciation allowances'' means the depreciation deductions allowable under section 167 to the possession corporation.

(B) Categories of property

(i) Qualified tangible property

The term ''qualified tangible property'' means any tangible property used by the possession corporation in a possession of the United States in the active conduct of a trade or business within such possession.

(ii) Short-life qualified tangible property

The term ''short-life qualified tangible property'' means any qualified tangible property to which section 168 applies and which is 3-year property or 5-year property for purposes of such section.

(iii) Medium-life qualified tangible property

The term ''medium-life qualified tangible property'' means any qualified tangible property to which section 168 applies and which is 7-year property or 10-year property for purposes of such section.

(iv) Long-life qualified tangible property

The term ''long-life qualified tangible property'' means any qualified tangible property to which section 168 applies and which is not described in clause (ii) or (iii).

(v) Transitional rule

In the case of any qualified tangible property to which section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applies, any reference in this paragraph to section 168 shall be treated as a reference to such section as so in effect.

(5) Election to compute credit on consolidated basis

(A) In general

Any affiliated group may elect to treat all possession corporations which would be members of such group but for section 1504(b)(3) or (4) as 1 corporation for purposes of this section. The credit determined under this section with respect to such 1 corporation shall be allocated among such possession corporations in such manner as the Secretary may prescribe.

(B) Election

An election under subparagraph (A) shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

(6) Possession corporation

The term ''possession corporation'' means a domestic corporation for which the election provided in subsection (a) is in effect.

(j) Termination

(1) In general

Except as otherwise provided in this subsection, this section shall not apply to any taxable year beginning after December 31, 1995.

(2) Transition rules for active business income credit

Except as provided in paragraph (3)—

(A) Economic activity credit

In the case of an existing credit claimant—

(i) with respect to a possession other than Puerto Rico, and

(ii) to which subsection (a)(4)(B) does not apply,

the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 2002.

(B) Special rule for reduced credit

(i) In general

In the case of an existing credit claimant to which subsection (a)(4)(B) applies, the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 1998.

(ii) Election irrevocable after 1997

An election under subsection (a)(4)(B)(iii) which is in effect for the taxpayer's last taxable year beginning before 1997 may not be revoked unless it is revoked for the taxpayer's first taxable year beginning in 1997 and all subsequent taxable years.

(C) Economic activity credit for Puerto Rico

For economic activity credit for Puerto Rico, see section 30A.

(3) Additional restricted credit

(A) In general

In the case of an existing credit claimant—

(i) the credit under subsection (a)(1)(A) shall be allowed for the period beginning with the first taxable year after the last taxable year to which subparagraph (A) or (B) of paragraph (2), whichever is appropriate, applied and ending with the last taxable year beginning before January 1, 2006, except that

(ii) the aggregate amount of taxable income taken into account under subsection (a)(1)(A) for any such taxable year shall not exceed the adjusted base period income of such claimant.

(B) Coordination with subsection (a)(4)

The amount of income described in subsection (a)(1)(A) which is taken into account in applying subsection (a)(4) shall be such income as reduced under this paragraph.

(4) Adjusted base period income

For purposes of paragraph (3)—

(A) In general

The term ''adjusted base period income'' means the average of the inflation-adjusted possession incomes of the corporation for each base period year.

(B) Inflation-adjusted possession income

For purposes of subparagraph (A), the inflation-adjusted possession income of any

corporation for any base period year shall be an amount equal to the sum of—

(i) the possession income of such corporation for such base period year, plus

(ii) such possession income multiplied by the inflation adjustment percentage for such base period year.

(C) Inflation adjustment percentage

For purposes of subparagraph (B), the inflation adjustment percentage for any base period year means the percentage (if any) by which—

(i) the CPI for 1995, exceeds

(ii) the CPI for the calendar year in which the base period year for which the determination is being made ends.

For purposes of the preceding sentence, the CPI for any calendar year is the CPI (as defined in section 1(f)(5)) for such year under section 1(f)(4).

(D) Increase in inflation adjustment percentage for growth during base years

The inflation adjustment percentage (determined under subparagraph (C) without regard to this subparagraph) for each of the 5 taxable years referred to in paragraph (5)(A) shall be increased by—

(i) 5 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1995;

(ii) 10.25 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1994;

(iii) 15.76 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1993;

(iv) 21.55 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1992; and

(v) 27.63 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1991.

(5) Base period year

For purposes of this subsection—

(A) In general

The term ''base period year'' means each of 3 taxable years which are among the 5 most recent taxable years of the corporation ending before October 14, 1995, determined by disregarding—

(i) one taxable year for which the corporation had the largest inflation-adjusted possession income, and

(ii) one taxable year for which the corporation had the smallest inflation-adjusted possession income.

(B) Corporations not having significant possession income throughout 5-year period

(i) In general

If a corporation does not have significant possession income for each of the most recent 5 taxable years ending before October 14, 1995, then, in lieu of applying subparagraph (A), the term ''base period year'' means only those taxable years (of such 5 taxable years) for which the corporation has significant possession income; except that, if such corporation has significant possession income for 4 of such 5 taxable years, the rule of subparagraph (A)(ii) shall apply.

(ii) Special rule

If there is no year (of such 5 taxable years) for which a corporation has significant possession income—

(I) the term ''base period year'' means the first taxable year ending on or after October 14, 1995, but

(II) the amount of possession income for such year which is taken into account under paragraph (4) shall be the amount which would be determined if such year were a short taxable year ending on September 30, 1995.

(iii) Significant possession income

For purposes of this subparagraph, the term ''significant possession income'' means possession income which exceeds 2 percent of the possession income of the taxpayer for the taxable year (of the period of 6 taxable years ending with the first taxable year ending on or after October 14, 1995) having the greatest possession income.

(C) Election to use one base period year

(i) In general

At the election of the taxpayer, the term ''base period year'' means—

(I) only the last taxable year of the corporation ending in calendar year 1992, or

(II) a deemed taxable year which includes the first ten months of calendar year 1995.

(ii) Base period income for 1995

In determining the adjusted base period income of the corporation for the deemed taxable year under clause (i)(II), the possession income shall be annualized and shall be determined without regard to any extraordinary item.

(iii) Election

An election under this subparagraph by any possession corporation may be made only for the corporation's first taxable year beginning after December 31, 1995, for which it is a possession corporation. The rules of subclauses (II) and (III) of subsection (a)(4)(B)(iii) shall apply to the election under this subparagraph.

(D) Acquisitions and dispositions

Rules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of this subsection.

(6) Possession income

For purposes of this subsection, the term ''possession income'' means, with respect to any possession, the income referred to in subsection (a)(1)(A) determined with respect to that possession. In no event shall possession income be treated as being less than zero.

(7) Short years

If the current year or a base period year is a short taxable year, the application of this

subsection shall be made with such annualizations as the Secretary shall prescribe.

(8) Special rules for certain possessions

(A) In general

In the case of an existing credit claimant with respect to an applicable possession, this section (other than the preceding paragraphs of this subsection) shall apply to such claimant with respect to such applicable possession for taxable years beginning after December 31, 1995, and before January 1, 2006.

(B) Applicable possession

For purposes of this paragraph, the term ''applicable possession'' means Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

(9) Existing credit claimant

For purposes of this subsection—

(A) In general

The term ''existing credit claimant'' means a corporation—

(i)(I) which was actively conducting a trade or business in a possession on October 13, 1995, and

(II) with respect to which an election under this section is in effect for the corporation's taxable year which includes October 13, 1995, or

(ii) which acquired all of the assets of a trade or business of a corporation which—

(I) satisfied the requirements of subclause (I) of clause (i) with respect to such trade or business, and

(II) satisfied the requirements of subclause (II) of clause (i).

(B) New lines of business prohibited

If, after October 13, 1995, a corporation which would (but for this subparagraph) be an existing credit claimant adds a substantial new line of business (other than in an acquisition described in subparagraph (A)(ii)), such corporation shall cease to be treated as an existing credit claimant as of the close of the taxable year ending before the date of such addition.

(C) Binding contract exception

If, on October 13, 1995, and at all times thereafter, there is in effect with respect to a corporation a binding contract for the acquisition of assets to be used in, or for the sale of assets to be produced from, a trade or business, the corporation shall be treated for purposes of this paragraph as actively conducting such trade or business on October 13, 1995. The preceding sentence shall not apply if such trade or business is not actively conducted before January 1, 1996.

(10) Separate application to each possession

For purposes of determining—

(A) whether a taxpayer is an existing credit claimant, and

(B) the amount of the credit allowed under this section,

this subsection (and so much of this section as relates to this subsection) shall be applied separately with respect to each possession.

(Added Pub. L. 94–455, title X, §1051(b), Oct. 4, 1976, 90 Stat. 1643; amended Pub. L. 94–455, title XIX, §1901(b)(37)(B), Oct. 4, 1976, 90 Stat. 1803; Pub. L. 95–600, title VII, §701(u)(11)(A), (B), Nov. 6, 1978, 92 Stat. 2917; Pub. L. 97–248, title II, §201(d)(8)(B), formerly §201(c)(8)(B), §213(a), Sept. 3, 1982, 96 Stat. 420, 452, renumbered §201(d)(8)(B), Pub. L. 97–448, title III, §306(a)(1)(A)(i), Jan. 12, 1983, 96 Stat. 2400; Pub. L. 98–369, div. A, title IV, §474(r)(22), title VII, §712(g), title VIII, §801(d)(11), July 18, 1984, 98 Stat. 843, 947, 997; Pub. L. 99–499, title V, §516(b)(1)(B), Oct. 17, 1986, 100 Stat. 1770; Pub. L. 99–514, title II, §231(d)(3)(G), title VII, §701(e)(4)(I), title XII, §§1231(a)–(d), (f), 1275(a)(1), title XVIII, §1812(c)(4)(C), Oct. 22, 1986, 100 Stat. 2179, 2343, 2561–2563, 2598, 2835; Pub. L. 100–647, title I, §§1002(h)(3), 1012(h)(2)(B), (j), (n)(4), (5), title VI, §6132(a), Nov. 10, 1988, 102 Stat. 3370, 3502, 3512, 3515, 3721; Pub. L. 101–382, title II, §227(a), Aug. 20, 1990, 104 Stat. 661; Pub. L. 101–508, title XI, §11704(a)(11), Nov. 5, 1990, 104 Stat. 1388–518; Pub. L. 103–66, title XIII, §13227(a), (b), Aug. 10, 1993, 107 Stat. 489, 490; Pub. L. 104–188, title I, §§1601(a), 1704(t)(37), (80), Aug. 20, 1996, 110 Stat. 1827, 1889, 1891; Pub. L. 108–357, title IV, §402(b)(2), Oct. 22, 2004, 118 Stat. 1492.)

REFERENCES IN TEXT

The date of the enactment of the Tax Reform Act of 1986, referred to in subsecs. (d)(3)(B) and (i)(4)(B)(v), is the date of enactment of Pub. L. 99–514, which was approved Oct. 22, 1986.

The Caribbean Basin Economic Recovery Act, referred to in subsec. (d)(4)(A)(i), (B), is title II of Pub. L. 98–67, Aug. 5, 1983, 97 Stat. 384, which is classified principally to chapter 15 (§2701 et seq.) of Title 19, Customs Duties. Section 212 of that Act is classified to section 2702 of Title 19. For complete classification of this Act to the Code, see Short Title note set out under section 2701 of Title 19 and Tables.

The date of the enactment of this subparagraph, referred to in subsec. (h)(3)(A), means the date of enactment of Pub. L. 97–248, which was approved Sept. 3, 1982.

The date of the enactment of this clause, referred to in subsec. (h)(5)(B)(iii)(I), (iv), means the date of enactment of Pub. L. 97–248, which was approved Sept. 3, 1982.

Section 230 of the Social Security Act, referred to in subsec. (i)(1)(B)(i), is classified to section 430 of Title 42, The Public Health and Welfare.

AMENDMENTS

2004—Subsec. (a)(2)(A). Pub. L. 108–357 substituted ''subsections (f) and (g) of section 904'' for ''section 904(f)''.

1996—Subsec. (a)(4)(A)(ii)(I). Pub. L. 104–188, §1704(t)(80), which directed that subcl. (I) be amended by substituting ''depreciation'' for ''deprecation'', could not be executed, because the word ''deprecation'' did not appear in text.

Subsec. (b). Pub. L. 104–188, §1704(t)(37), substituted ''subparagraphs (D)(ii)'' for ''subparagraphs (D)(ii)(I)''.

Subsec. (j). Pub. L. 104–188, §1601(a), added subsec. (j).

1993—Subsec. (a)(1). Pub. L. 103–66, §13227(a)(1), substituted ''Except as otherwise provided in this section'' for ''Except as provided in paragraph (3)''.

Subsec. (a)(4). Pub. L. 103–66, §13227(a)(2), added par. (4).

Subsec. (i). Pub. L. 103–66, §13227(b), added subsec. (i).

1990—Subsec. (d)(4)(D). Pub. L. 101–382 added subpar. (D).

Subsec. (e)(1). Pub. L. 101–508 substituted ''subsection (a)(2)'' for ''subsection (a)(1)'' wherever appearing.

1988—Subsec. (d)(3)(B). Pub. L. 100–647, §1012(j), inserted ''(as in effect on the day before the date of the

enactment of the Tax Reform Act of 1986)'' after ''section 957(c)''.

Subsec. (d)(4)(A)(ii). Pub. L. 100–647, §1012(n)(5)(A), amended cl. (ii) generally. Prior to amendment, cl. (ii) read as follows: ''in accordance with a specific authorization granted by the Government Development Bank for Puerto Rico pursuant to regulations issued by the Secretary of the Treasury of Puerto Rico.''

Subsec. (d)(4)(B). Pub. L. 100–647, §6132(a), inserted ''and the Virgin Islands'' after ''274(h)(6)(A)''.

Subsec. (d)(4)(C)(i), (ii). Pub. L. 100–647, §1012(n)(5)(B), substituted ''Commissioner of Financial Institutions of Puerto Rico'' for ''Secretary of the Treasury of Puerto Rico''.

Subsec. (h)(5)(C)(i)(I). Pub. L. 100–647, §1012(n)(4), amended directory language of Pub. L. 99–514, §1231(a)(1), see 1986 Amendment note below.

Subsec. (h)(5)(C)(i)(IV)(c). Pub. L. 100–647, §1002(h)(3), substituted ''section 41'' and ''section 41(f)'' for ''section 30'' and ''section 30(f)'', respectively.

Subsec. (h)(7), (8). Pub. L. 100–647, §1012(h)(2)(B), added par. (7) and redesignated former par. (7) as (8).

1986—Subsec. (a)(2)(B). Pub. L. 99–514, §1231(d)(1), substituted ''75 percent'' for ''65 percent''.

Subsec. (a)(2)(C). Pub. L. 99–514, §1231(d)(2), struck out subpar. (C), transitional rule, which read as follows: ''In applying subparagraph (B) with respect to taxable years beginning after December 31, 1982, and before January 1, 1985, the following percentage shall be substituted for '65 percent':

''For taxable years beginning in calendar year:	**The percentage is:**
1983	55
1984	60.''

Subsec. (a)(3). Pub. L. 99–499 in par. (3), as amended by Pub. L. 99–514, added subpar. (A) and redesignated former subpars. (A) to (C) as (B) to (D), respectively.

Pub. L. 99–514, §701(e)(4)(I), struck out subpar. (A) which read ''section 56 (relating to corporate minimum tax),'', and redesignated subpars. (B), (C), and (E) as (A), (B), and (C), respectively.

Subsec. (b). Pub. L. 99–514, §1231(b), inserted at end ''This subsection shall not apply to any amount described in subsection (a)(1)(A)(i) received from a person who is not a related person (within the meaning of subsection (h)(3) but without regard to subparagraphs (D)(ii)(I) and (E)(i) thereof) with respect to the domestic corporation.''

Subsec. (d)(1). Pub. L. 99–514, §1275(a)(1), substituted ''and the Virgin Islands'' for '', but does not include the Virgin Islands of the United States''.

Subsec. (d)(4). Pub. L. 99–514, §1231(c), added par. (4).

Subsec. (h)(3)(D)(ii). Pub. L. 99–514, §1812(c)(4)(C), amended cl. (ii) generally. Prior to amendment, cl. (ii), special rules, read as follows: ''For purposes of clause (i)—

''(I) section 267(b) and section 707(b)(1) shall be applied by substituting '10 percent' for '50 percent', and

''(II) section 267(b)(3) shall be applied without regard to whether a person was a personal holding company or a foreign personal holding company.''

Subsec. (h)(5)(C)(i)(I). Pub. L. 99–514, §1231(a)(1), as amended by Pub. L. 100–647, §1012(n)(4), in introductory provisions, substituted ''the same proportion of 110 percent of the cost'' for ''the same proportion of the cost'', and inserted at end of material relating to payment of cost sharing ''In the case of intangible property described in subsection (h)(3)(B)(i) which the electing corporation is treated as owning under subclause (II), in no event shall the payment required under this subclause be less than the inclusion or payment which would be required under section 367(d)(2)(A)(ii) or section 482 if the electing corporation were a foreign corporation.''

Subsec. (h)(5)(C)(i)(I)(a). Pub. L. 99–514, §231(d)(3)(G), substituted ''section 41(b)'' for ''section 30(b)''.

Subsec. (h)(5)(C)(ii)(II). Pub. L. 99–514, §1231(f), substituted ''all products and types of services, within such product area, produced or rendered'' for ''all products produced and types of service rendered''.

Pub. L. 99–514, §1231(a)(2), substituted ''the third and fourth sentences thereof, but substituting '120 percent' for '110 percent' in the second sentence thereof)'' for ''the third sentence thereof)''.

1984—Subsec. (a)(2)(C). Pub. L. 98–369, §712(g), substituted in table heading ''The percentage is'' for ''The percentage tax is''.

Subsec. (f). Pub. L. 98–369, §801(d)(11), amended subsec. (f) generally, substituting in heading ''Limitation on credit for DISC's and FSC's'' for ''DISC or former DISC corporation ineligible for credit'', and in text striking out reference to section 992(a) and inserting provision disallowing a credit to a corporation for a taxable year in which it owns at any time stock in a FSC or former FSC.

Subsec. (h)(5)(C)(i)(I)(a). Pub. L. 98–369, §474(r)(22)(A), substituted ''section 30(b)'' for ''section 44F(b)''.

Subsec. (h)(5)(C)(i)(IV)(c). Pub. L. 98–369, §474(r)(22)(B), substituted ''section 30'' for ''section 44F'' and ''section 30(f)'' for ''section 44F(f)''.

1982—Subsec. (a)(2)(B). Pub. L. 97–248, §213(a)(1)(A), substituted ''65 percent'' for ''50 percent''.

Subsec. (a)(2)(C). Pub. L. 97–248, §213(a)(1)(B), added subpar. (C).

Subsec. (a)(3)(A). Pub. L. 97–248, §201(d)(8)(B), formerly §201(c)(8)(B), substituted ''(relating to corporate minimum tax)'' for ''(relating to minimum tax)''.

Subsec. (h). Pub. L. 97–248, §213(a)(2), added subsec. (h).

1978—Subsec. (a). Pub. L. 95–600, §701(u)(11)(A), reworked provisions of par. (1) into introductory text, substituting reference to par. (3) for reference to par. (2), and subpars. (A) and (B), inserted introductory text of par. (2), redesignated former subpars. (A) and (B) of par. (1) as subpars. (A) and (B) of par. (2), and redesignated former par. (2) as (3).

Subsec. (d). Pub. L. 95–600, §701(u)(11)(B), substituted in heading ''Definitions and special rules'' for ''Definitions'' and added par. (3).

1976—Subsec. (a)(2)(D). Pub. L. 94–455, §1901(b)(37)(B), struck out subpar. (D) relating to war loss recoveries.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108–357 applicable to losses for taxable years beginning after Dec. 31, 2006, see section 402(c) of Pub. L. 108–357, set out as a note under section 535 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by section 1601(a) of Pub. L. 104–188 applicable to taxable years beginning after Dec. 31, 1995, except as otherwise provided, see section 1601(c) of Pub. L. 104–188, set out as an Effective Date note under section 30A of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103–66 applicable to taxable years beginning after Dec. 31, 1993, see section 13227(f) of Pub. L. 103–66, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Section 227(b) of Pub. L. 101–382 provided that: ''The amendment made by subsection (a) [amending this section] shall apply to calendar years after 1989.''

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by sections 1002(h)(3) and 1012(h)(2)(B), (j), (n)(4), (5) of Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

Section 6132(b) of Pub. L. 100–647 provided that: ''The amendment made by this section [amending this section] shall apply to investments made after the date of the enactment of this Act [Nov. 10, 1988].''

EFFECTIVE DATE OF 1986 AMENDMENTS

Amendment by section 231(d)(3)(G) of Pub. L. 99–514 applicable to taxable years beginning after Dec. 31,

1985, see section 231(g) of Pub. L. 99–514, set out as a note under section 41 of this title.

Amendment by section 701(e)(4)(I) of Pub. L. 99–514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 701(f) of Pub. L. 99–514, set out as an Effective Date note under section 55 of this title.

Section 1231(g) of Pub. L. 99–514, as amended by Pub. L. 100–647, title I, §1012(n)(1)–(3), Nov. 10, 1988, 102 Stat. 3514, provided that:

''(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section [amending this section and sections 367 and 482 of this title] shall apply to taxable years beginning after December 31, 1986.

''(2) SPECIAL RULE FOR TRANSFER OF INTANGIBLES.—

''(A) IN GENERAL.—The amendments made by subsection (e) [amending sections 367 and 482 of this title] shall apply to taxable years beginning after December 31, 1986, but only with respect to transfers after November 16, 1985, or licenses granted after such date (or before such date with respect to property not in existence or owned by the taxpayer on such date). In the case of any transfer (or license) which is not to a foreign person, the preceding sentence shall be applied by substituting 'August 16, 1986' for 'November 16, 1985'.

''(B) SPECIAL RULE FOR SECTION 936.—For purposes of section 936(h)(5)(C) of the Internal Revenue Code of 1986 the amendments made by subsection (e) shall apply to taxable years beginning after December 31, 1986, without regard to when the transfer (or license), if any, was made.

''(3) SUBSECTION (f).—The amendment made by subsection (f) [amending this section] shall apply to taxable years beginning after December 31, 1982.

''(4) TRANSITIONAL RULE.—In the case of a corporation—

''(A) with respect to which an election under section 936 of the Internal Revenue Code of 1986 (relating to possessions tax credit) is in effect,

''(B) which produced an end-product form in Puerto Rico on or before September 3, 1982,

''(C) which began manufacturing a component of such product in Puerto Rico in its taxable year beginning in 1983, and

''(D) with respect to which a Puerto Rican tax exemption was granted on June 27, 1983,

such corporation shall treat such component as a separate product for such taxable year for purposes of determining whether such corporation had a significant business presence in Puerto Rico with respect to such product and its income with respect to such product.

''(5) TRANSITIONAL RULE FOR INCREASE IN GROSS INCOME TEST.—

''(A) IN GENERAL.—If—

''(i) a corporation fails to meet the requirements of subparagraph (B) of section 936(a)(2) of the Internal Revenue Code of 1986 (as amended by subsection (d)(1)) for any taxable year beginning in 1987 or 1988,

''(ii) such corporation would have met the requirements of such subparagraph (B) if such subparagraph had been applied without regard to the amendment made by subsection (d)(1), and

''(iii) 75 percent or more of the gross income of such corporation for such taxable year (or, in the case of a taxable year beginning in 1988, for the period consisting of such taxable year and the preceding taxable year) was derived from the active conduct of a trade or business within a possession of the United States, such corporation shall nevertheless be treated as meeting the requirements of such subparagraph (B) for such taxable year if it elects to reduce the amount of the qualified possession source investment income for the taxable year by the amount of the shortfall determined under subparagraph (B) of this paragraph.

''(B) DETERMINATION OF SHORTFALL.—The shortfall determined under this subparagraph for any taxable year is an amount equal to the excess of—

''(i) 75 percent of the gross income of the corporation for the 3-year period (or part thereof) referred to in section 936(a)(2)(A) of such Code, over

''(ii) the amount of the gross income of such corporation for such period (or part thereof) which was derived from the active conduct of a trade or business within a possession of the United States.

''(C) SPECIAL RULE.—Any income attributable to the investment of the amount not treated as qualified possession source investment income under subparagraph (A) shall not be treated as qualified possession source investment income for any taxable year.''

Amendment by section 1275(a)(1) of Pub. L. 99–514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 1277 of Pub. L. 99–514, set out as a note under section 931 of this title.

Amendment by section 1812(c)(4)(C) of Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

Amendment by Pub. L. 99–499 applicable to taxable years beginning after Dec. 31, 1986, see section 516(c) of Pub. L. 99–499, set out as a note under section 26 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 474(r)(22) of Pub. L. 98–369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98–369, set out as a note under section 21 of this title.

Amendment by section 712(g) of Pub. L. 98–369 effective as if included in the provision of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97–248, to which such amendment relates, see section 715 of Pub. L. 98–369, set out as a note under section 31 of this title.

Amendment by section 801(d)(11) of Pub. L. 98–369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98–369, as amended, set out as a note under section 245 of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by section 201(d)(8)(B) of Pub. L. 97–248 applicable to taxable years beginning after Dec. 31, 1982, see section 201(e)(1) of Pub. L. 97–248, set out as a note under section 5 of this title.

Section 213(e) of Pub. L. 97–248, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

''(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section [amending this section and sections 246, 367, and 934 of this title] shall apply to taxable years beginning after December 31, 1982.

''(2) CERTAIN SALES MADE AFTER JULY 1, 1982.—Paragraph (6) of section 936(h) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], and so much of section 934 to which such paragraph applies by reason of section 934(e)(4) of such Code, shall apply to taxable years ending after July 1, 1982.

''(3) CERTAIN TRANSFERS OF INTANGIBLES MADE AFTER AUGUST 14, 1982.—Subsection (d) [amending section 367 of this title] shall apply to taxable years ending after August 14, 1982.''

EFFECTIVE DATE OF 1978 AMENDMENT

Section 701(u)(11)(C) of Pub. L. 95–600, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: ''The amendments made by this paragraph [amending this section] shall apply as if included in section 936 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] at the time of its addition by section 1051(b) of the Tax Reform Act of 1976 [Oct. 4, 1976].''

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94–455 applicable with respect to taxable years beginning after Dec. 31, 1976, see sec-

tion 1901(d) of Pub. L. 94–455, set out as a note under section 2 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1975, except that qualified possession source investment income as defined in subsec. (d)(2) of this section shall include income from any source outside the United States if the taxpayer establishes to the satisfaction of the Secretary of the Treasury or his delegate that the income from such sources was earned before Oct. 1, 1976, see section 1051(i) of Pub. L. 94–455, set out as an Effective Date of 1976 Amendment note under section 27 of this title.

APPLICABILITY OF CERTAIN AMENDMENTS BY PUB. L. 99–514 IN RELATION TO TREATY OBLIGATIONS OF UNITED STATES

For applicability of amendment by section 701(e)(4)(I) of Pub. L. 99–514 notwithstanding any treaty obligation of the United States in effect on Oct. 22, 1986, with provision that for such purposes any amendment by title I of Pub. L. 100–647 be treated as if it had been included in the provision of Pub. L. 99–514 to which such amendment relates, see section 1012(aa)(2), (4) of Pub. L. 100–647, set out as a note under section 861 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101–1147 and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

REPORT ON POSSESSIONS CORPORATIONS

Section 441(a) of Pub. L. 98–369, as amended by Pub. L. 99–514, § 2, Oct. 22, 1986, 100 Stat. 2095; Pub. L. 100–647, title VI, § 6252(b)(1), Nov. 10, 1988, 102 Stat. 3752, which directed Secretary of the Treasury to submit a report to Congress each fourth calendar year on the operation and effect of sections 936 and 934(b) of this title, terminated, effective May 15, 2000, pursuant to section 3003 of Pub. L. 104–66, as amended, set out as a note under section 1113 of Title 31, Money and Finance. See, also, page 142 of House Document No. 103–7.

§ 937. Residence and source rules involving possessions

(a) Bona fide resident

For purposes of this subpart, section 865(g)(3), section 876, section 881(b), paragraphs (2) and (3) of section 901(b), section 957(c), section 3401(a)(8)(C), and section 7654(a), except as provided in regulations, the term ''bona fide resident'' means a person—

(1) who is present for at least 183 days during the taxable year in Guam, American Samoa, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands, as the case may be, and

(2) who does not have a tax home (determined under the principles of section 911(d)(3) without regard to the second sentence thereof) outside such specified possession during the taxable year and does not have a closer connection (determined under the principles of section 7701(b)(3)(B)(ii)) to the United States or a foreign country than to such specified possession.

For purposes of paragraph (1), the determination as to whether a person is present for any day shall be made under the principles of section 7701(b).

(b) Source rules

Except as provided in regulations, for purposes of this title—

(1) except as provided in paragraph (2), rules similar to the rules for determining whether income is income from sources within the United States or is effectively connected with the conduct of a trade or business within the United States shall apply for purposes of determining whether income is from sources within a possession specified in subsection (a)(1) or effectively connected with the conduct of a trade or business within any such possession, and

(2) any income treated as income from sources within the United States or as effectively connected with the conduct of a trade or business within the United States shall not be treated as income from sources within any such possession or as effectively connected with the conduct of a trade or business within any such possession.

(c) Reporting requirement

(1) In general

If, for any taxable year, an individual takes the position for United States income tax reporting purposes that the individual became, or ceases to be, a bona fide resident of a possession specified in subsection (a)(1), such individual shall file with the Secretary, at such time and in such manner as the Secretary may prescribe, notice of such position.

(2) Transition rule

If, for any of an individual's 3 taxable years ending before the individual's first taxable year ending after the date of the enactment of this subsection, the individual took a position described in paragraph (1), the individual shall file with the Secretary, at such time and in such manner as the Secretary may prescribe, notice of such position.

(Added Pub. L. 108–357, title VIII, § 908(a), Oct. 22, 2004, 118 Stat. 1655.)

REFERENCES IN TEXT

The date of the enactment of this subsection, referred to in subsec. (c)(2), is the date of enactment of Pub. L. 108–357, which was approved Oct. 22, 2004.

EFFECTIVE DATE

Pub. L. 108–357, title VIII, § 908(d), Oct. 22, 2004, 118 Stat. 1657, provided that:

''(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section [enacting this section and amending sections 931, 932, 934, 935, 957, and 6688 of this title] shall apply to taxable years ending after the date of the enactment of this Act [Oct. 22, 2004].

''(2) 183-DAY RULE.—Section 937(a)(1) of the Internal Revenue Code of 1986 (as added by this section) shall apply to taxable years beginning after the date of the enactment of this Act.

''(3) SOURCING.—Section 937(b)(2) of such Code (as so added) shall apply to income earned after the date of the enactment of this Act.''