

#### 924. Foreign trading gross receipts

(a) In general. -- Except as otherwise provided in this section, for purposes of this subpart, the term "foreign trading gross receipts" means the gross receipts of any FSC which are --

(1) from the sale, exchange, or other disposition of export property,  
(2) from the lease or rental of export property for use by the lessee outside the United States,

(3) for services which are related and subsidiary to --  
(A) any sale, exchange, or other disposition of export property by such corporation, or  
(B) any lease or rental of export property described in paragraph (2) by such corporation,

(4) for engineering or architectural services for construction projects located (or proposed for location) outside the United States, or

(5) for the performance of managerial services for an unrelated FSC or DISC in furtherance of the production of foreign trading gross receipts described in paragraph (1), (2), or (3).

Paragraph (5) shall not apply to a FSC for any taxable year unless at least 50 percent of its gross receipts for such taxable year is derived from activities described in paragraph (1), (2), or (3).

(b) Foreign management and foreign economic process requirements. --

(1) In general. -- Except as provided in paragraph (2) --

(A) a FSC shall be treated as having foreign trading gross receipts for the taxable year only if the management of such corporation during such taxable year takes place outside the United States as required by subsection (c), and

(B) a FSC has foreign trading gross receipts from any transaction only if economic processes with respect to such transaction take place outside the United States as required by subsection (d).

(2) Exception for small FSC. --

(A) In general. -- Paragraph (1) shall not apply with respect to any small FSC.

(B) Limitation on amount of foreign trading gross receipts of small FSC taken into account. --

(i) In general. -- Any foreign trading gross receipts of a small FSC for the taxable year which exceed \$5,000,000 shall not be taken into account in determining the exempt foreign trade income of such corporation and shall not be taken into account under any other provision of this subpart.

(ii) Allocation of limitation. -- If the foreign trading gross receipts of a small FSC exceed the limitation of clause (i), the corporation may allocate such limitation among such gross receipts in such manner as it may select (at such time and in such manner as may be prescribed in regulations).

(iii) Receipts of controlled group aggregated. -- For purposes of applying clauses (i) and (ii), all small FSC's which are members of the same controlled group of corporations shall be treated as a single corporation.

(iv) Allocation of limitation among members of controlled group. -- The limitation under clause (i) shall be allocated among the foreign trading gross receipts of small FSC's which are members of the same controlled group of corporations in a manner provided in regulations prescribed by the Secretary.

(c) Requirement that FSC be managed outside the United States. -- The management of a FSC meets the requirements of this subsection for the taxable year if --

(1) all meetings of the board of directors of the corporation, and all meetings of the shareholders of all corporation, are outside the United States,

(2) the principal bank account of the corporation is maintained in a foreign country which meets the requirements of section 927(e)(3) or in a possession of the United States at all times during the taxable year, and

(3) all dividends, legal and accounting fees, and salaries of officers and members of the board of directors of the corporation disbursed during the taxable year are disbursed out of bank accounts of the corporation maintained outside the United States.

(d) Requirements that economic processes take place outside the United States. --

(1) In general. -- The requirements of this subsection are met with respect to the gross receipts of a FSC derived from an transaction if --

(A) such corporation (or any person acting under a contract with such corporation) has participated outside the United States in the solicitation (other than advertising), the negotiation, or the making of the contract relating to such transaction, and

(B) the foreign direct costs incurred by the FSC attributable to the transaction equal or exceed 50 percent of the total direct cost attributable to the transaction.

(2) Alternative 85-percent test. -- A corporation shall be treated as satisfying the requirements of paragraph (1)(B) with respect to any transaction if, with respect to each of at least 2 paragraphs of subsection (e), the foreign direct costs incurred by such corporation attributable to activities described in such paragraph equal or exceed 85 percent of the total direct costs attributable to activities described in such paragraph.

(3) Definitions. -- For purposes of this subsection --

(A) Total direct costs. -- The term "total direct costs" means, with respect to any transaction, the total direct costs incurred by the FSC attributable to activities described in subsection (e) performed at any location by the FSC or any person acting under a contract with such FSC.

(B) Foreign direct costs. -- The term "foreign direct costs" means, with respect to any transaction, the portion of the total direct costs which are attributable to activities performed outside the United States.

(4) Rules for commissions, etc. -- The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (e) in the case of commissions, rentals, and furnishing of

services.

(e) Activities relating to disposition of export property. -- The activities referred to in subsection (d) are --

- (1) advertising and sales promotion,
- (2) the processing of customer orders and the arranging for delivery of the export property,
- (3) transportation from the time of acquisition by the FSC (or, in the case of a commission relationship, from the beginning of such relationship for such transaction) to the delivery to the customer.

(4) the determination and transmittal of a final invoice or statement of account and the receipt of payment, and

(5) the assumption of credit risk.

(f) Certain receipts not included in foreign trading gross receipts. --

(1) Certain receipts excluded on basis of use; subsidized receipts and receipts from related parties excluded. -- The term "foreign trading gross receipts" shall not include receipts of a FSC from a transaction if --

(A) the export property or services --

(i) are for ultimate use in the United States, or

(ii) are for use by the United States or any instrumentality thereof and such use of export property or services is required by law or regulation.

(B) such transaction is accomplished by a subsidy granted by the United States or any instrumentality thereof, or services is required by law or regulation.

(C) such receipts are from another FSC which is a member of the same controlled group of corporations of which such corporation is a member.

In the case of gross receipts of a FSC from a transaction involving any property, subparagraph (C) shall not apply if such FSC (and all other FSC's which are members of the same controlled group and which receive gross receipts from a transaction involving such property) do not use the pricing rules under paragraph (1) of section 925(a) (or the corresponding provisions of the regulations prescribed under section 925(b)) with respect to any transaction involving such property.

(2) Investment income; carrying charges. -- The term "foreign trading gross receipts" shall not include any investment income or carrying charges.

## 925. Transfer pricing rules

(a) In general. -- In the case of a sale of export property to a FSC by a person described in section 482, the taxable income of such FSC and such person shall be based upon a transfer price which would allow such FSC to derive taxable income attributable to such sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of --

(1) 1.83 percent of the foreign trading gross receipts derived from the sale of such property by such FSC,

(2) 23 percent of the combined taxable income of such FSC and such

person which is attributable to the foreign trading gross receipts derived from the sale of such property by such FSC, or

(3) taxable income based upon the sale price actually charged (but subject to the rules provided in section 482).

Paragraphs (1) and (2) shall apply only if the FSC meets the requirements of subsection (c) with respect to the sale.

(b) Rules for commissions, rentals, and marginal costing. -- The Secretary shall prescribe regulations setting forth --

(1) rules which are consistent with the rules set forth in subsection (a) for the application of this section in the case of commissions, rentals, and other income, and

(2) rules for the allocation of expenditures in computing combined taxable income under subsection (a)(2) in those cases where a FSC is seeking to establish or maintain a market for export property.

(c) Requirements for use of administrative pricing rules. -- A sale by a FSC meets the requirements of this subsection if--

(1) all of the activities described in section 924(e) attributable to such sale, and

(2) all of the activities relating to the solicitation (other than advertising), negotiation, and making of the contract for such sale, have been performed by such FSC (or by another person acting under a contract with such FSC).

(d) Limitation on gross receipts pricing rule. -- The amount determined under subsection (a)(1) with respect to any transaction shall not exceed 2 times the amount which would be determined under subsection (a)(2) with respect to such transaction.

(e) Taxable income. -- For purposes of this section, the taxable income of a FSC shall be determined without regard to section 921.

(f) Special rule for cooperatives. -- In any case in which a qualified cooperative sells export property to a FSC, in computing the combined taxable income of such FSC and such organization for purposes of subsection (a)(2), there shall not be taken into account any deduction allowable under subsection (b) or (c) of section 1.382 (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

## 926. Distributions to shareholders

(a) Distributions made first out of foreign trade income. -- For purposes of this title, any distribution to a shareholder of a FSC by such FSC which is made out of earnings and profits shall be treated as made --

(1) first, out of earnings and profits attributable to foreign trade income, to the extent thereof, and

(2) then, out of any other earnings and profits.

(b) Distributions by FSC to nonresident aliens and foreign corporations treated as United States connected. -- For purposes of this title, any distribution by a FSC which is made out of earnings and profits attributable to foreign trade income to any shareholder of such corporation

which is a foreign corporation or a nonresident alien individual shall be treated as a distribution --

- (1) which is effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States, and
- (2) of income which is derived from sources within the United States.
- (c) FSC includes former FSC. -- For purposes of this section, the term "FSC" includes a former FSC.

#### 927. Other definitions and special rules

- (a) Export property. -- For purposes of this subpart --
  - (1) In general. -- The term "export property" means property --
    - (A) manufactured, produced, grown, or extracted in the United States by a person other than a FSC,
    - (B) held primarily for sale, lease, or rental, in the ordinary course of trade or business, by, or to, a FSC, for direct use, consumption, or disposition outside the United States, and
    - (C) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.For purposes of subparagraph (C), the fair market value of any article imported into the United States shall be its appraised value, as determined by the Secretary under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401(a)) in connection with its importation.
  - (2) Excluded property. -- The term "export property" shall not include --
    - (A) property leased or rented by a FSC for use by any member of a controlled group of corporations of which such FSC is a member,
    - (B) patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, for commercial or home use), good will, trademarks, trade brands, franchises, or other like property,
    - (C) oil or gas (or any primary product thereof), or
    - (D) products the export of which is prohibited or curtailed to effectuate the policy set forth in paragraph (2)(C) of section 3 of the Export Administration Act of 1979 (relating to the protection of the domestic economy).
  - (3) Property in short supply. -- If the President determines that the supply of any property described in paragraph (1) is insufficient to meet the requirements of the domestic economy, he may by Executive order designate the property as in short supply. Any property so designated shall not be treated as export property during the period beginning with the date specified in the Executive order and ending with the date specified in an Executive order setting forth the President's determination that the property is no longer in short supply.
  - (4) Qualified cooperative. -- The term "qualified cooperative" means any organization to which part I of subchapter T applies which is engaged in

the marketing of agricultural or horticultural products.

(b) Gross receipts. --

(1) In general. -- For purposes of this subpart, the term "gross receipts" means --

(A) the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of trade or business, and

(B) gross income from all other sources.

(2) Gross receipts taken into account in case of commissions. -- In the case of commissions on the sale, lease, or rental of property, the amount taken into account for purposes of this subpart as gross receipts shall be the gross receipts on the sale, lease, or rental of the property on which such commissions arose.

(c) Investment income. -- For purposes of this subpart, the term "investment income" means --

(1) dividends,

(2) interest,

(3) royalties,

(4) annuities,

(5) rents (other than rents from the lease or rental of export property for use by the lessee outside of the United States),

(6) gains from the sale or exchange of stock or securities,

(7) gains from futures transactions in any commodity on, or subject to the rules of, a board of trade or commodity exchange (other than gains which arise out of a bona fide hedging transaction <sup>reasm!2@</sup> <sup>jl-L</sup> <sup>!rKé</sup> <sup>#</sup> <sup>||HHn</sup> <sup>é-</sup> <sup>|H@</sup> <sup>iness of the FSC in the manner in which such business is customarily conducted by others),</sup>

(8) amounts includible in computing the taxable income of the corporation under part I of subchapter J, and

(9) gains from the sale or other disposition of any interest in an estate or trust.

(d) Other definitions. -- For purposes of this subpart --

(1) Carrying charges. -- The term "transaction" means --

(A) carrying charges, and

(B) under regulations prescribed by the Secretary, any amount in excess of the price for an immediate cash sale and any other unstated interest,

(2) Transaction. --

(A) In general. -- The term "transaction" means --

(i) any sale, exchange, or other disposition,

(ii) any lease or rental, and

(iii) any furnishing of services.

(B) Grouping of transactions. -- To the extent provided in regulations, any provision of this subpart which, but for this subparagraph, would be applied on a transaction-by-transaction basis may be applied by the taxpayer on the basis of groups of transactions based on product lines or recognized

industry or trade usage. Such regulations may permit different groupings for different purposes.

(3) United States defined. -- The term "United States" includes the Commonwealth of Puerto Rico.

(4) Controlled group of corporations. -- The term "controlled group of corporations" has the meaning given to such term by section 1563(a), except that --

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein, and

(B) section 1563(b) shall not apply.

(5) Possessions. -- The term "possession of the United States" means Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands of the United States.

(6) Section 923(a)(2) non-exempt income. -- The term "section 923(a)(2) non-exempt income" means any foreign trade income from a transaction with respect to which paragraph (1) or (2) of section 925(a) does not apply and which is not exempt foreign trade income. Such term shall not include any income which is effectively connected with the conduct of a trade or business within the United States (determined without regard to this subpart).

(e) Special rules. --

(1) Source rules for related persons. -- Under regulations, the income of a person described in section 482 from a transaction giving rise to foreign trading gross receipts of a FSC which is treated as from sources outside the United States shall not exceed the amount which would be treated as foreign source income earned by such person if the pricing rule under section 994 which corresponds to the rule used under section 925 with respect to such transaction applied to such transaction.

(2) Participation in international boycotts, etc. -- Under regulations prescribed by the Secretary, the exempt foreign trade income of a FSC for any taxable year shall be limited under rules similar to the rules of clauses (ii) and (iii) of section 995(b)(1)(F).

(3) Exchange of information requirements. -- For purposes of this title, the term "FSC" shall not include any corporation which was created or organized under the laws of any foreign country unless there is in effect between such country and the United States --

(A) a bilateral or multilateral agreement described in section 274(h)(6)(C) (determined by treating any reference to a beneficiary country and by applying such section without regard to clause (ii) thereof), or

(B) an income tax treaty which contains an exchange of information program --

(i) which the Secretary certifies (and has not revoked such certification ) is satisfactory in practice for purposes of this title, and

(ii) to which the FSC is subject.

(4) Disallowance of treaty benefits. -- Any corporation electing to be treated as a FSC under subsection (f)(1) may not claim any benefits under

any income tax treaty between the United States and any foreign country.

(5) Coordination with possessions taxation. --

(A) Exemption. -- No tax shall be imposed by any possession of the United States on any foreign trade income derived before January 1, 1987. The preceding sentence shall not apply to any income attributable to the sale of property or the performance of services for ultimate use, consumption, or disposition within the possession.

(B) Clarification that possession may exempt certain income from tax. -- Nothing in any provision of law shall be construed as prohibiting any possession of the United States from exempting from tax any foreign trade income of a FSC or any other income of a FSC described in paragraph (2) or (3) of section 921(d).

(C) No cover over of taxes imposed on FSC. -- Nothing in any provision of law shall be construed as requiring any tax imposed by this title on a FSC to be covered over (or otherwise transferred) to any possession of the United States.

(f) Election of status as FSC (and as small FSC). --

(1) Election. --

(A) Time for making. -- An election by a corporation under section 922(a)(2) to be treated as a FSC, and an election under section 922(b)(1) to be a small FSC, shall be made by such corporation for a taxable year at any time during the 90-day period immediately preceding the beginning of the taxable year, except that the Secretary may give his consent to the making of an election at such other times as he may designate.

(B) Manner of election. -- An election under subparagraph (A) shall be made in such manner as the Secretary shall prescribe and shall be valid only if all persons who are shareholders in such corporation on the first day of the first taxable year for which such election is effective consent to such election.

(2) Effect of election. -- If a corporation makes an election under paragraph (1), then the provisions of this subpart shall apply to such corporation for the taxable year of the corporation for which made and for all succeeding taxable years.

(3) Termination of election. --

(A) Revocation. -- An election under this subsection made by any corporation may be terminated by revocation of such election for any taxable year of the corporation after the first taxable year of the corporation for which the election is effective. A termination under this paragraph shall be effective with respect to such election --

(i) for the taxable year in which made, if made at any time during the first 90 days of such taxable year, or

(ii) for the taxable year following the taxable year in which made, if made after the close of such 90 days, and for all succeeding taxable years of the corporation. Such termination shall be made in such manner as the Secretary shall prescribe by regulations.

(B) Continued failure to be a FSC. -- If a corporation is not a FSC for



each of any 5 consecutive taxable years of the corporation for which an election under this subsection is effective, the election to be a FSC shall be terminated and not be in effect for any taxable year of the corporation after such 5th year.

(g) Treatment of shared FSC's. --

(1) In general. -- Except as provided in paragraph (2), each separate account referred to in paragraph (3) maintained by a shared FSC shall be treated as a separate corporation for purposes of this subpart.

(2) Certain requirements applied at shared FSC level. -- Paragraph (1) shall not apply --

(A) for purposes of --

(i) subparagraphs (A), (B), (D), and (E) of section 922(a)(1),

(ii) paragraph (2) of section 922(a),

(iii) subsections (b), (c), and (e) of section 924, and

(iv) subsection (f) of this section, and

(B) for such other purposes as the Secretary may by regulations prescribe.

(3) Shared FSC. -- For purposes of this subsection, the term "shared FSC" means any corporation if --

(A) such corporation maintains a separate account for transactions with each shareholder (and persons related to such shareholder),

(B) distributions to each shareholder are based on the amounts in the separate account maintained with respect to such shareholder, and

(C) such corporation meets such other requirements as the Secretary may by regulations prescribe.

931. Income from sources within Guam, American Samoa, or the Northern Mariana Islands

(a) General rule. -- In the case of an individual who is a bona fide resident of a specified possession during the entire taxable year, gross income shall not include --

(1) income derived from sources within any specified possession, and

(2) income effectively connected with the conduct of a trade or business by such individual within any specified possession.

(b) Deductions, etc. allocable to excluded amounts not allowable. -- An individual shall not be allowed --

(1) as a deduction from gross income any deductions (other than the deduction under section 151, relating to personal exemptions), or

(2) any credit, properly allocable or chargeable against amounts excluded from gross income under this section.

(c) Specified possession. -- For purposes of this section, the term "specified possession" means Guam, American Samoa, and the Northern Mariana Islands.

(d) Special rules. -- For purposes of this section --

(1) Employees of the United States. -- Amounts paid for services performed as an employee of the United States (or any agency thereof) shall be treated as not described in paragraph (1) or (2) of subsection (a).

(2) Determination of source, etc. -- The determination as to whether income is described in paragraph (1) or (2) of subsection (a) shall be made under regulations prescribed by the Secretary.

(3) Determination of residency. -- For purposes of this section and section 876, the determination of whether an individual is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands shall be made under regulations prescribed by the Secretary.

### 932. Coordination of United States and Virgin Islands income taxes

(a) Treatment of United States residents. --

(1) Application of subsection. -- This subsection shall apply to an individual for the taxable year if --

(A) such individual --

(i) is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands at the close of the taxable year), and

(ii) has income derived from sources within the Virgin Islands, or effectively connected with the conduct of a trade or business within such possession, for the taxable year, or

(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

(2) Filing requirement. -- Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with both the United States and the Virgin Islands.

(3) Extent of income tax liability. -- In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title (other than this section and section 7654) as related to the taxes imposed by this chapter, the United States shall be treated as including the Virgin Islands.

(b) Portion of United States tax liability payable to the Virgin Islands.

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(1) In general. -- Each individual to whom subsection (a) applies for the taxable year shall pay the applicable percentage of the taxes imposed by this chapter for such taxable year (determined without regard to paragraph (3)) to the Virgin Islands.

(2) Applicable percentage. --

(A) In general. -- For purposes of paragraph (1), the term "applicable percentage" means the percentage which Virgin Islands adjusted gross income bears to adjusted gross income.

(B) Virgin Islands adjusted gross income. -- For purposes subparagraph (A), the term "Virgin Islands adjusted gross income" means adjusted gross income determined by taking into account only income derived from sources within the Virgin Islands and deductions properly apportioned or allocable thereto.

(3) Amounts paid allowed as credit. -- There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the taxes required to be paid to the Virgin Islands under paragraph (1) which are so paid.

(c) Treatment of Virgin Islands residents. --

(1) Application of subsection. -- This subsection shall apply to an individual for the taxable year if --

(A) such individual is a bona fide resident of the Virgin Islands at the close of the taxable year, or

(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

(2) Filing requirement. -- Each individual to whom this subsection applies for the taxable year shall file an income tax return for the taxable year with the Virgin Islands.

(3) Extent of income tax liability. -- In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title 9 (other than this section and section 7654) as relates to the taxes imposed by this chapter, the Virgin Islands shall be treated as including the United States.

(4) Residents of the Virgin Islands. -- In the case of an individual --

(A) who is a bona fide resident of the Virgin Islands at the close of the taxable year,

(B) who, on his return of income tax to the Virgin Islands, reports income from all sources and identifies the source of each item shown on such return, and

(C) who fully pays his tax liability referred to in section 934(a) to the Virgin Islands with respect to such income, for purposes of calculating income tax liability to the United States, gross income shall not include any amount included in gross income on such return, and allocable deductions and credits shall not be taken into account.

(d) Special rule for joint returns. -- In the case of a joint return, this section shall be applied on the basis of the residence of the spouse who has the greater adjusted gross income (determined without regard to community property laws) for the taxable year.

(e) Special rule for applying section to tax imposed in Virgin Islands. -- In applying this section for purposes of determining income tax liability incurred to the Virgin Islands, the provisions of this section shall not be affected by the provisions of Federal law referred to in section 934(a).

### 933. Income from sources within Puerto Rico

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Resident of Puerto Rico for entire taxable year. -- In the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, income derived from sources within Puerto Rico (except amounts received for services performed as an employee of the United

States or any agency thereof); but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Taxable year of change of residence from Puerto Rico. -- In the case of an individual citizen of the United States who has been a bona fide resident of Puerto Rico for a period of at least 2 years before the date on which he changes his residence from Puerto Rico, income derived from sources therein (except amounts received for services performed as an employee of the United States or any agency thereof) which is attributable to that part of such period of Puerto Rican residence before such date; but such individual shall not be allowed as a deduction from his gross income any deductions (other than the deduction for personal exemptions under section 151), or any credit, properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

#### 934. Limitation on reduction in income tax liability incurred to the Virgin Islands

(a) General rule. -- Tax liability incurred to the Virgin Islands pursuant to this subtitle, as made applicable in the Virgin Islands by the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in subsection (b).

(b) Reductions permitted with respect to certain income. --

(1) In general. -- Except as provided in paragraph (2), subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands.

(2) Exception for liability paid by citizens or residents of the United States. -- Paragraph (1) shall not apply to any liability payable to the Virgin Islands under section 932(b).

(3) Special rule for non-United States income of certain foreign corporations. --

(A) In general. -- In the case of a qualified foreign corporation, subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income which is derived from sources outside the United States and which is not effectively connected with the conduct of a trade or business within the United States.

(B) Qualified foreign corporation. -- For purposes of subparagraph (A), the term "qualified foreign corporation" means any foreign corporation if

less than 10 percent of --

(i) the total voting power of the stock of such corporation, and  
(ii) the total value of the stock of such corporation, is owned or treated as owned (within the meaning of section 958) by 1 or more United States persons.

(4) Determination of income source, etc. -- The determination as to whether income is derived from sources within the Virgin Islands or the United States or is effectively connected with the conduct of a trade or business within the Virgin Islands or the United States shall be made under regulations prescribed by the Secretary.

934A. Repealed.

935. Repealed.

936. Puerto Rico and possession tax credit

(a) Allowance of credit. --

(1) In general. -- Except as provided in paragraph (3), 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 section 904(f)); 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).

(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. The 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.

(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 established 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 investments 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). 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

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(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 th

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) Definitions. -- 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 service 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 service 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 test 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. --

(l) 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 costs 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) -- 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 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) Produce 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 produce 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)(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 corporation's 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 of 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)(1) 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 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, 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 in 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 source 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 subparagraph (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 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.