with respect to any election made pursuant to this section even though the revocation or termination may occur after December 28, 1980.

[T.D. 7635, 44 FR 46457, Aug. 8, 1979, as amended by T.D. 7928, 48 FR 55846, Dec. 16, 1983. Redesignated at 53 FR 35477, Sept. 14, 1988]

§ 1.861–16 Income from certain craft first leased after December 28, 1980.

(a) *General rule.* If a taxpayer—

(1) Owns a qualified craft (as defined in paragraph (b) of this section).

(2) Leases such qualified craft after December 28, 1980, to a United States person that is not a member of the same controlled group of corporations as the taxpayer, and

(3) The lease is the taxpayer's first lease of the craft and the taxpayer is not considered to have made an election with respect to the craft under § 1.861–9(e)(2),

then the taxpayer shall treat all amounts includible in gross income with respect to the qualified craft as income from sources within the United States for each taxable year ending after commencement of the lease. If this section applies to income with respect to a craft, it applies to all such amounts that are includible in the taxpayer's gross income, whether or not includible during or after the period of a lease to a United States person. Amounts derived by the taxpayer with respect to the qualified craft include any gain from the sale, exchange, or other disposition of the qualified craft. If this section applies to income with respect to a craft and there is a loss with respect to that craft (either due to the allowance of expenses and other deductions or due to a sale, exchange, or other disposition of the qualified craft), such loss is treated as allocable or apportionable to sources within the United States. The fact that a craft ceases to be section 38 property, ceases to be leased by the taxpayer to a United States person, or is leased or subleased for any period of time to a person who is not a United States person will not terminate the application of this section.

(b) *Qualified craft*—(1) *In general.* A qualified craft is a vessel, aircraft, or spacecraft that—

(i) Is section 38 property (or would be section 38 property but for section 48(a)(5), relating to use by governmental units), and

(ii) Is manufactured or constructed in the United States.

(2) *Vessel.* The term ''vessel'' includes every type of watercraft capable of being used as a means of transportation on water, and any items of property that are affixed in a permanent fashion or are integral to the vessel. A vessel that is used predominately outside the United States must be described in section 48(a)(2)(B)(iii) and § 1.48–1(g)(2)(iii), relating to vessels documented for use in the foreign or domestic commerce of the United States, to be a qualified craft.

(3) *Aircraft.* An aircraft used predominantly outside the United States must be described in section 48(a)(2)(B)(i) and § 1.48–1(g)(2)(i), relating to aircraft registered by the Administrator of the Federal Aviation Agency, and operated to and from the United States or operated under contract with the United States, to be a qualified craft.

(4) *Spacecraft.* A spacecraft must be described in section 48(a)(2)(B)(viii) and § 1.48–1(g)(2)(viii), relating to communications satellites, or any interest therein, of a United States person, to be a qualified craft.

(5) *United States manufacture or construction.* A craft will be considered to be manufactured or constructed in the United States if 50 percent or more of the basis of the craft on the date of the lease to a United States person is attributable to value added within the United States.

(c) *United States person.* For purposes of this section, the term ''United States person'' includes those persons described in section 7701(a)(30) and individuals with respect to whom an election under section 6013 (g) or (h) (relating to nonresident alien individuals married to United States citizens or residents) is in effect.

(d) *Controlled group.* For purposes of paragraph (a)(2) of this section, whether a taxpayer and a United States person are members of the same controlled group of corporations is determined under section 1563. Solely for purposes of this section, if at least 80% of the capital interest, or the profits

interest, in a partnership is owned, directly or indirectly, by a member or members of a controlled group of corporations, then the partnership shall be considered a member of that controlled group of corporations. In addition, if at least 80% of the capital interest, or the profits interest, in a partnership is owned, directly or indirectly, by a corporation, then the partnership and that corporation shall be considered members of a controlled group of corporations.

(e) *Certain transfers and distributions*—(1) *Transfers and distributions involving carryover of basis.* If—

(i) The income with respect to a craft is subject to this section,

(ii) The taxpayer transfers or distributes such craft, and

(iii) The basis of such craft in the hands of the transferee or distributee is determined by reference to its basis in the hands of the transferor or distributor,

then this section will apply to the income with respect to the craft includible in the gross income of the transferee or distributee. This paragraph (e)(1) applies even though the transferor or distributor recognizes an amount of gain that increases basis in the hands of the transferee or distributee and even though the transferee or distributee is a nonresident alien or foreign corporation. For example, if a corporation distributes a craft the income of which is subject to this section to its parent corporation in a complete liquidation described in section 332(b), the parent corporation will be treated as if it satisified the requirements of paragraph (a) of this section with respect to such craft if the basis of the property in the hands of the parent corporation is determined under section 334(b) (relating to the general rule on carryover of basis in liquidations). In further illustration, if a corporation distributes a craft the income of which is subject to this section, in a distribution to which section 301(a) applies, the distributee will be treated as if it satisfied the requirements of paragraph (a) of this section with respect to such craft if its basis is determined under section 301(d)(2) (relating to basis of corporate distributees) even though the basis may be the fair market value of the craft under section 301(d)(2)(A).

(2) *Partnerships.* If a partnership satisfies the requirements of paragraph (a)(1), (2), and (3) of this section, each partner shall treat all amounts includible in gross income with respect to the craft as income from sources within the United States for any taxable year of the partnership ending after commencement of the lease. In addition, if a partnership distributes a craft the income of which is subject to this section, to a partner, the partner will be treated as if he or she satisfied the requirements of paragraph (a) of this section with respect to such craft.

(3) *Affiliated groups.* If a member of a group of corporations that files a consolidated return transfers a craft, the income of which is subject to this section, to another member of that same group, the transferee will be treated as if it satisfied the requirements of paragraph (a) of this section with respect to the craft.

[T.D. 7928, 48 FR 55846, Dec. 16, 1983. Redesignated by T.D. 8228, 53 FR 35477, Sept. 14, 1988]

§ 1.861–17 Allocation and apportionment of research and experimental expenditures.

(a) *Allocation*—(1) *In general.* The methods of allocation and apportionment of research and experimental expenditures set forth in this section recognize that research and experimentation is an inherently speculative activity, that findings may contribute unexpected benefits, and that the gross income derived from successful research and experimentation must bear the cost of unsuccessful research and experimentation. Expenditures for research and experimentation that a taxpayer deducts under section 174 ordinarily shall be considered deductions that are definitely related to all income reasonably connected with the relevant broad product category (or categories) of the taxpayer and therefore allocable to all items of gross income as a class (including income from sales, royalties, and dividends) related