Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2005–30, page 1015.

Deferred annuity contract. This ruling addresses the treatment of certain amounts received under a deferred annuity contract as income in respect of a decedent (IRD) under section 691 of the Code. Rev. Rul. 79–335 modified and superseded.

T.D. 9194, page 1016.
REG–159243–03, page 1075.

Final, temporary, and proposed regulations under section 937 of the Code provide rules for determining whether an individual is a bona fide resident of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands. The regulations also provide rules for determining when income is considered to be from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business within a U.S. possession. In addition, conforming changes are made and/or proposed to regulations under related sections of the Code. A public hearing on the proposed regulations is scheduled for July 21, 2005.

Notice 2005–37, page 1049.

Renewable electricity production and refined coal production; calendar year 2005 inflation adjustment factor and reference prices. This notice announces the calendar year 2005 inflation adjustment factor and reference prices for the renewable electricity production credit and refined coal production credit under section 45 of the Code.

ESTATE TAX

Rev. Rul. 2005–30, page 1015.

Deferred annuity contract. This ruling addresses the treatment of certain amounts received under a deferred annuity contract as income in respect of a decedent (IRD) under section 691 of the Code. Rev. Rul. 79–335 modified and superseded.

ADMINISTRATIVE

Rev. Proc. 2005–27, page 1050.

This procedure provides an updated list of time-sensitive acts, the performance of which may be postponed under sections 7508 and 7508A of the Code. Section 7508 postpones specified acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces in a combat zone. Section 7508A of the Code permits a postponement of specified acts for taxpayers affected by a Presidentially declared disaster or a terroristic or military action. The list of acts in this procedure supplements the list of postponed acts in section 7508(a)(1) of the Code and section 301.7508A–1(b) of the regulations. Rev. Proc. 2004–13 superseded.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72(d)–1: "Amounts not received as an annuity".

How a death benefit received by the beneficiary of a deferred annuity contract after the death of the owner-annuitant will be treated under section 72(e). See Rev. Rul. 2005-30, page 1015.

Section 691.—Recipients of Income in Respect of Decedents

26 CFR 1.691(a)–1: Income in respect of a decedent. (Also §§ 72, 1014.)

Deferred annuity contract. This ruling addresses the treatment of certain amounts received under a deferred annuity contract as income in respect of a decedent (IRD) under section 691 of the Code. Rev. Rul. 79–335 modified and superseded.

Rev. Rul. 2005–30

ISSUE

If the owner-annuitant of a deferred annuity contract dies before the annuity starting date, and the beneficiary receives a death benefit under the annuity contract (either in a lump sum or as periodic payments), is the amount received by the beneficiary in excess of the owner-annuitant's investment in the contract includible in the beneficiary's gross income as income in respect of a decedent (IRD) within the meaning of § 691 of the Internal Revenue Code?

FACTS

A purchased a deferred annuity contract providing for annuity payments to *A* beginning as of a date specified in the annuity contract. *A* named *B* as beneficiary of the contract. The contract provides that *A* may surrender the contract during *A*'s life for its account value as determined by the formula provided under the contract. The contract further provides that if *A* dies before the annuity starting date, *B* will receive a death benefit equal to the account value as determined by the formula provided under the contract. At *B*'s election, the death benefit will be paid either in a lump sum or as periodic payments consistent with the provisions of § 72(s).

A dies before the annuity starting date and *B* receives the death benefit under the contract, which exceeds *A*'s investment in the contract.

LAW AND ANALYSIS

Section 72(a) provides that gross income includes any amount received as an annuity. Sections 72(b) through (d) provide rules for determining what portion of an annuity payment represents a non-taxable return of investment. Section 72(e) provides rules for amounts received under an annuity contract, but not received as an annuity (and therefore not described in § 72(b) through (d)). Specifically, amounts received before the annuity starting date are generally includible in gross income to the extent allocable to the income on the annuity contract. Section 72(s) provides rules regarding the period in which an interest in an annuity contract must be distributed after the holder's death in order for the contract to qualify as an annuity contract within the meaning of § 72.

Section 691(a)(1) provides that the amount of all items of gross IRD that are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive the amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) is included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of the right.

Section 691(c)(1) provides that a person who includes an amount of IRD in gross income under § 691(a) is allowed as a deduction, for the same taxable year, a portion of the estate tax paid by reason of the inclusion of that IRD in the decedent's gross estate. Generally, the amount of the deduction is calculated using estate tax values, and is the amount that bears the same ratio to the estate tax attributable to the net value of all IRD items included in the decedent's gross estate as the value of the IRD included in that person's gross income for that taxable year bears to the value of all IRD items included in the decedent's gross estate.

Section 1014(a)(1) provides that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent generally is the fair market value of the property at the date of the decedent's death. This rule does not apply if the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person.

Section 1014(b)(9) provides that, for purposes of § 1014(a), property acquired from the decedent by reason of death, form of ownership, or other conditions if by reason thereof the property is required to be included in determining the value of the decedent's gross estate for estate tax purposes, is considered to have been acquired from, or to have passed from, the decedent.

Section 1014(b)(9)(A) provides that § 1014(b)(9) does not apply to annuities described in § 72.

Section 1014(c) provides that § 1014 does not apply to property that constitutes a right to receive an item of IRD under § 691.

Rev. Rul. 79–335, 1979–2 C.B. 292, addresses a situation in which the owner-annuitant purchases a deferred variable annuity contract that provides that if the owner dies prior to the annuity starting date, the named beneficiary may elect to receive the present accumulated value of the contract either in the form of an annuity or a lump-sum payment. Rev. Rul. 79–335 concludes that, for purposes

of § 1014, the contract is an annuity described in § 72 (as then in effect), and therefore receives no basis adjustment by reason of the owner's death because it is governed by the annuity exception of § 1014(b)(9)(A). If the beneficiary elects a lump-sum payment, the excess of the amount received over the amount of consideration paid by the decedent is includable in the beneficiary's gross income. Rev. Rul. 79–335 prospectively revokes Rev. Rul. 70–143, 1970–1 C.B. 167, which had concluded on substantially identical facts that such a contract, if surrendered by the beneficiary prior to the annuity starting date, is not an annuity described in § 72 and therefore is not governed by the rule of § 1014(b)(9)(A), and that the beneficiary receives the date of death value as the basis in the contract.

Although Rev. Rul. 79–335 concludes that the annuity exception in § 1014(b)(9)(A) applies to the contract described in that ruling, it does not specifically address whether amounts received by a beneficiary under a deferred annuity contract in excess of the owner-annuitant's investment in the contract would be subject to §§ 691 and 1014(c). However, had the owner-annuitant surrendered the contract and received the amounts in excess of the owner-annuitant's investment in the contract, those amounts would have been income to the owner-annuitant under § 72(e). Because those amounts would have been income to the owner-annuitant if the contract had been surrendered during life, those amounts are IRD under § 691.

Likewise, in the present case, had *A* surrendered the contract and received the amounts at issue, those amounts would have been income to *A* under § 72(e) to the extent they exceeded *A*'s investment in the contract. Accordingly, amounts that *B* receives that exceed *A*'s investment in the contract are IRD under § 691(a). As provided in Rev. Rul. 79–335, those amounts are includible in *B*'s gross income and *B* does not receive a basis adjustment in the contract. However, *B* will be entitled to a deduction under § 691(c) if estate tax was due by reason of *A*'s death. The result would be the same whether *B* receives the death benefit in a lump sum or as periodic payments.

HOLDING

If the owner-annuitant of a deferred annuity contract dies before the annuity starting date, and the beneficiary receives a death benefit under the annuity contract, the amount received by the beneficiary in a lump sum in excess of the owner-annuitant's investment in the contract is includible in the beneficiary's gross income as IRD within the meaning of § 691. If the death benefit is instead received in the form of a series of periodic payments in accordance with § 72(s), the amounts received are likewise includible in the beneficiary's gross income (in an amount determined under § 72) as IRD within the meaning of § 691.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 79–335 is modified and superseded for deferred annuity contracts purchased on or after October 21, 1979. The holding of Rev. Rul. 70–143 (which was revoked by Rev. Rul. 79–335) will continue to apply for deferred annuity contracts purchased before October 21, 1979, including any contributions applied to those contracts pursuant to a binding commitment entered into before that date.

DRAFTING INFORMATION

The principal author of this revenue ruling is Bradford R. Poston of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue ruling, contact Bradford R. Poston at (202) 622–3060 (not a toll-free call).

Section 937.—Residence and Source Rules Involving Possessions

26 CFR 1.937–1T: Bona fide residency in a possession (temporary).

T.D. 9194

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations that provide rules under section 937(a) of the Internal Revenue Code (Code) for determining whether an individual is a bona fide resident of the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands. The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business within a U.S. possession. Section 937 was added to the Code by section 908 of the American Jobs Creation Act (2004 Act).

The temporary regulations also provide updated guidance under sections 876, 881, 884, 931, 932, 933, 934, 935, 957, and 6688 of the Code to reflect amendments made by the Tax Reform Act of 1986 (1986 Act) and the 2004 Act. Conforming changes are also made to regulations under sections 170A, 243, 702, 861, 863, 871, 901, 1402, 6038, 6046, and 7701 of the Code. The text of the temporary regulations also serves as the text of the proposed regulations (REG–159243–03) set forth in the cross-referenced notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date*: These regulations are effective April 11, 2005.

FOR FURTHER INFORMATION CONTACT: J. David Varley (202) 435–5165 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1930. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The income tax laws of the United States have always contained special provisions concerning the income taxation of individuals residing in U.S. possessions and corporations created or organized in U.S. possessions. See *e.g.*, sections 260 and 261 of Public Law 65–254 (40 Stat. 1057). The current rules for residents of the Commonwealth of Puerto Rico (Puerto Rico) were first enacted in 1950. See sections 220 and 221 of Public Law 81–814 (64 Stat. 906) (enacting the predecessors to sections 876 and 933 of the Code). Special rules for residents of the United States Virgin Islands (USVI) were added in 1960. See section 4 of Public Law 86–779 (74 Stat. 998) (enacting section 934 of the Code). Special rules for residents of Guam were added in 1972. See Public Law 92–606 (86 Stat. 1494) (1972 Act) (enacting sections 935 and 7654 of the Code). These special rules for residents of Guam were made applicable to residents of the Commonwealth of the Northern Mariana Islands (NMI) for tax years beginning after December 31, 1978. See section 601 of Public Law 94–241 (90 Stat. 263) and Presidential Proclamation 4534.

The 1986 Act substantially revised the provisions governing the income taxation of individuals residing in U.S. possessions. See sections 1271 through 1277 of Public Law 99–514 (amending sections 876, 931 through 935, 957(c), and 7654 of the Code). The 2004 Act restated and supplemented certain aspects of these provisions. See section 908 of Public Law 108–357 (enacting section 937 of the Code). These regulations conform the existing regulations to the amended statutes and provide additional guidance on the proper application of the statutory provisions.

This document contains amendments to 26 CFR parts 1, 301, and 602. The cross-referenced notice of proposed rulemaking is published elsewhere in this issue of the Bulletin.

Explanation of Provisions

I. *Operative Provisions*

Many of the substantive and procedural provisions of the Code specifically relating to the possessions were amended by the 1986 Act. The 2004 Act further amended certain of these provisions. These regulations implement the statutory changes by modifying or replacing existing regulations as discussed below.

A. *Puerto Rico*

Individuals who are U.S. citizens generally are subject to U.S. Federal income tax on their worldwide income, regardless of source, under section 1 of the Code. As discussed in section I.F. of this explanation, alien individuals who qualify as bona fide residents of Puerto Rico (and certain other possessions) likewise are subject to U.S. Federal income tax on their worldwide income under section 1.

Under section 933, income from sources within Puerto Rico is excluded from gross income of bona fide residents of Puerto Rico (whether U.S. citizens or alien individuals) for U.S. Federal income tax purposes. Consequently, such individuals have a U.S. Federal income tax return filing obligation only if their income from sources outside Puerto Rico exceeds their deductions under section 151 relating to personal exemptions. To the extent such income constitutes income from sources outside the United States, such individuals generally may claim a foreign tax credit under section 901(b) for income taxes paid to foreign countries and U.S. possessions (including Puerto Rico) to offset their U.S. Federal income tax liability, subject to certain limitations.

Deductions (other than the deduction under section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under section 933 generally have been disallowed since the statute was enacted in 1950. The 1986 Act amended section 933 to provide for a similar disallowance of credits. These regulations amend the existing regulations under section 933 to reflect this statutory change.

B. *American Samoa, Guam, and the Northern Mariana Islands*

Section 931, as enacted in the 1986 Act, operates in a similar fashion to section 933. For U.S. citizens and alien individuals who are bona fide residents of possessions to which it applies (section 931 possessions), income from sources within such possessions or effectively connected with the conduct of a trade or business in such possessions is excluded from gross income for U.S. Federal income tax purposes. Consequently, such individuals have a U.S. Federal income tax return filing obligation only if their income from sources outside section 931 possessions and not effectively connected with the conduct of a trade or business in such possessions exceeds their deductions under section 151 relating to personal exemptions. To the extent such income constitutes income from sources outside the United States, U.S. citizens who are bona fide residents of section 931 possessions generally may

claim a foreign tax credit under section 901(b) for income taxes paid to foreign countries and U.S. possessions (including section 931 possessions) to offset their U.S. Federal income tax liability, subject to certain limitations. As under section 933, any deductions (other than the deduction under section 151, relating to personal exemptions) and credits properly allocable or chargeable against amounts excluded from gross income under section 931 are disallowed.

Although section 931 by its terms applies to bona fide residents of American Samoa, Guam, and the NMI (collectively, the Pacific possessions), the statute takes effect with respect to any such possession only when the possession enters into an implementing agreement with the Internal Revenue Service as required under the relevant effective date provisions of the 1986 Act. See sections 1271(b) and 1277(b) of Public Law 99–514. To date, only American Samoa has entered into such an agreement. Consequently, section 931 currently applies only to bona fide residents of American Samoa.

Although section 935 was repealed by the 1986 Act, the effective date of its repeal is contingent on the entry into force of implementing agreements, as described above, by the possessions to which section 935 historically has applied (section 935 possessions), namely, Guam and the NMI. Given that neither has agreed to the entry into force of such agreements, section 935 remains in force with respect to bona fide residents of Guam and the NMI.

Section 935, as in effect prior to its repeal, refers only to Guam. Pursuant to section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States, Public Law 94–241, however, the income tax laws of the United States entered into force in the NMI in the same manner as those laws are in force in Guam, and references in the Code to Guam generally are deemed also to refer to the NMI. Consequently, section 935 currently applies to bona fide residents of Guam and of the NMI.

These regulations amend the existing regulations under section 935 to reflect the fact that the section currently applies not only to bona fide residents of Guam but also to bona fide residents of the NMI, and may in the future apply only to bona fide residents of one or the other and will not apply to bona fide residents of either possession if both enter into the implementing agreements contemplated in the 1986 Act. Similarly, these regulations set forth the post-1986 Act statutory framework for residents of section 931 possessions in a manner that reflects the potential for bona fide residents of Guam and the NMI to be covered by its provisions upon entry into force of such implementing agreements.

C. *United States Virgin Islands*

Section 932, as enacted in the 1986 Act, provides two sets of operative rules: one for bona fide residents of the USVI, and one for U.S. citizens and resident alien individuals who are not bona fide residents of the USVI but have income from sources within the USVI or income effectively connected with the conduct of a trade or business in the USVI.

With respect to individuals who are bona fide residents of the USVI (whether U.S. citizens or alien individuals), section 932(c) generally provides that an income tax return must be filed with the USVI tax authorities. If the individual properly reports on this return his or her income from all sources and identifies the source of each item of income, and pays all of the tax properly due with respect to such income, then such income is excluded from gross income for U.S. Federal income tax purposes. Consequently, such individuals have a U.S. Federal income tax return filing obligation only if they fail to report or properly identify the source of some of their income on their USVI income tax return, or if they fail to pay all of the tax properly due with respect to their income (for example, by improperly claiming the benefit of a tax credit or exemption provided under USVI law but subject to the limitations of section 934(b)).

With respect to U.S. citizens and resident alien individuals who are not bona fide residents of the USVI but have income from sources within the USVI or income effectively connected with the conduct of a trade or business in the USVI, section 932(a) generally provides that each such individual must file his or her income tax return with both the IRS and with the USVI Bureau of Internal Revenue. In addition, under section 932(b), such an individual must pay to the USVI the "applicable percentage" of the taxes imposed under Chapter 1 of the Code. For this purpose, the term *applicable percentage* means the percentage which the individual's Virgin Islands adjusted gross income bears to the individual's adjusted gross income; the term *Virgin Islands adjusted gross income* means the individual's adjusted gross income determined by taking into account only income derived from sources within the Virgin Islands and deductions properly apportioned or allocable thereto. On the individual's U.S. Federal income tax return, he or she may claim a credit for the tax required to be paid to the USVI, so that only the remainder is due to the United States.

In general, the USVI administers income tax laws that are identical (except for the substitution of the name of the USVI for the term *United States* where appropriate) to those in force in the United States (commonly referred to as the mirror code). However, subject to the limitations of section 934(b), as amended by the 1986 Act, the USVI has the authority to reduce or remit tax liabilities under the mirror code in certain situations.

First, under section 934(b)(1), the USVI may reduce or remit the tax otherwise imposed on the income of any person (other than a U.S. citizen or resident alien individual who is not a bona fide resident of the USVI) from sources within the USVI or effectively connected with the conduct of a trade or business in the USVI.

Second, under section 934(b)(3), the USVI may reduce or remit the tax otherwise imposed on the income (other than income from sources within the United States or effectively connected with the conduct of a trade or business in the United States) of a foreign corporation, provided that less than ten percent of its stock (by vote and value) is owned by United States persons. Given that a corporation created or organized outside of the USVI can only have a mirror code tax liability with respect to income from sources within the USVI or effectively connected with the conduct of a trade or business within the USVI (all of which is within the scope of section 934(b)(1)), the additional waiver of the limitations of section 934(a) provided by section 934(b)(3) generally will have no practical effect for such corporations. Instead, section 934(b)(3) generally is relevant only to corporations created or orga-

nized in the USVI (which are treated as "foreign" corporations for U.S. Federal income tax purposes).

These regulations amend the existing regulations under section 934 and provide new regulations under section 932 to reflect this post-1986 Act statutory framework.

D. *U.S. tax liabilities of certain possessions corporations*

Section 881(a) generally imposes a 30 percent tax on U.S.-source fixed or determinable annual or periodical income of foreign corporations. Section 884 imposes certain branch-level taxes on foreign corporations that are engaged in a trade or business in the United States. Section 881(b) provides for the reduction or elimination of the taxes otherwise imposed under sections 881(a) and 884 on corporations created or organized in U.S. possessions (possessions corporations) under certain circumstances.

Section 881(b), as enacted by the 1972 Act, provides the rules currently in effect for corporations created or organized in section 935 possessions. Under these rules, such corporations effectively are exempt from tax under section 881(a), provided that the following conditions are satisfied—

(1) At all times during the taxable year, less than 25 percent in value of the stock of such corporation is owned (directly or indirectly) by foreign persons; and

(2) At least 20 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to have been derived from sources within such possession for the 3-year period ending with the close of the preceding taxable year of such corporation (or for such part of such period as the corporation has been in existence).

Section 881(b), as enacted by the 1972 Act, also provides the rules currently in effect for corporations created or organized in the United States that otherwise might incur a tax liability to a section 935 possession under a mirrored version of section 881(a). Under these rules, such corporations effectively are exempt from tax in the section 935 possession in all cases.

Section 881(b), as amended by the 1986 Act, provides the rules currently in effect for corporations created or organized in section 931 possessions and in the USVI. Under these rules, such corporations effectively are exempt from tax under section 881(a) and section 884, provided that the following conditions (1986 conditions) are satisfied—

(1) At all times during the taxable year, less than 25 percent in value of the stock of such corporation is beneficially owned (directly or indirectly) by foreign persons;

(2) At least 65 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to be effectively connected with the conduct of a trade or business in such a possession or the United States for the 3-year period ending with the close of the taxable year of such corporation (or for such part of such period as the corporation or any predecessor has been in existence); and

(3) No substantial part of the income of such corporation is used (directly or indirectly) to satisfy obligations to persons who are not bona fide residents of such a possession or the United States.

Corporations that are created or organized in section 935 possessions and satisfy the 1986 conditions also are exempt from the U.S. tax imposed under section 884. Similarly, corporations that are created or organized in the United States and satisfy the 1986 conditions are exempt from the tax imposed under mirrored versions of section 884 in section 935 possessions.

Section 881(b), as amended by the 2004 Act, provides a special rule for corporations created or organized in Puerto Rico. Under this rule, such corporations are subject to tax under section 881(a) at a rate of 10 percent (rather than the generally applicable rate of 30 percent) on their U.S.-source dividend income, provided that the 1986 conditions are satisfied. However, if, on or after October 22, 2004, there is an increase in the rate of Puerto Rico's withholding tax which is generally applicable to dividends paid to United States corporations not engaged in a trade or business in Puerto Rico to a rate greater than 10 percent, this special rule shall not apply to dividends received on or after the effective date of the increase.

These regulations amend the existing regulations under sections 881 and 884 to reflect this post-1986 Act and post-2004 Act statutory framework. These regulations also provide rules similar to the 1972 Act rules applicable to section 935 possessions for purposes of determining tax liability incurred to the USVI by corporations created or organized in the United States, pursuant to section 1274(c) of the 1986 Act.

E. *Application of subpart F to bona fide residents of a possession*

With respect to bona fide residents of section 935 possessions and the USVI (mirror code possessions), corporations created or organized in the possession in which they reside are treated as domestic corporations for mirror code tax purposes. Thus, provisions such as subpart F of part III of subchapter N of chapter 1 of the Code (relating to controlled foreign corporations) as mirrored do not apply with respect to their ownership of such corporations.

With respect to bona fide residents of section 931 possessions and Puerto Rico, corporations created or organized in the possession in which they reside are treated as foreign corporations for U.S. Federal income tax purposes. Thus, in cases where, after the application of section 931 or 933 as the case may be, such individuals are required to file U.S. Federal income tax returns, they generally must treat such corporations as foreign corporations for purposes of applying provisions, such as subpart F, to determine their U.S. Federal income tax liability.

Section 957(c), however, provides a significant exception for bona fide residents of section 931 possessions and Puerto Rico. In cases where it applies, the individual is not treated as a United States person for purposes of subpart F. Consequently, such individual is not treated as a United States shareholder under section 951(b), and possession corporations described in section 957(c) that are controlled by such individuals are not treated as controlled foreign corporations under section 957(a).

In the case of a bona fide resident of Puerto Rico, section 957(c)(1) applies with respect to a corporation organized under the laws of the Commonwealth of Puerto Rico if a dividend received by such individual during the taxable year from such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico. (As discussed in more detail below in section II.B. of this

explanation, such would be the case if, during a three-year testing period ending with the taxable year, the corporation's gross income was derived entirely from sources within Puerto Rico or the corporation met certain gross income and trade or business requirements.)

In the case of a bona fide resident of a section 931 possession, section 957(c)(2) applies with respect to a corporation organized under the laws of such a possession if the following conditions are satisfied—

(1) 80 percent or more of the gross income of the corporation for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within such a possession or was effectively connected with the conduct of a trade or business in such a possession; and

(2) 50 percent or more of the gross income of the corporation for such period (or part) was derived from the active conduct of a trade or business within such a possession.

These regulations amend the existing regulations under section 957 to reflect this post-1986 Act statutory framework. These regulations also make corresponding changes to the regulations under sections 6038 and 6046 (relating to information reporting requirements with respect to certain foreign corporations owned by United States persons).

F. *Taxation of aliens residing in a possession*

Under section 876, individuals who are nonresident aliens with respect to the United States and are bona fide residents of certain possessions are subject to U.S. Federal income tax on their worldwide income under section 1 (rather than solely on their income from sources within the United States or effectively connected with the conduct of a trade or business in the United States under section 871). Prior to the 1986 Act, section 876 applied only to alien individuals who were bona fide residents of Puerto Rico. As amended by the 1986 Act, section 876 applies also to alien individuals who are bona fide residents of section 931 possessions.

These regulations amend the existing regulations under section 876 to reflect this post-1986 Act statutory framework.

G. *Entity status*

The IRS and Treasury are aware that some taxpayers have deliberately treated business entities in an inconsistent manner for U.S. Federal income tax purposes and for purposes of determining income tax liabilities incurred to mirror code possessions, in order to reduce their overall tax liability below what otherwise would be due in the absence of the mirror system. The IRS and Treasury believe that such inconsistent treatment is inappropriate and contrary to the purpose of the mirror system. Accordingly, these regulations contain special rules requiring consistent treatment of business entities for U.S. and mirror code tax purposes.

Under these rules, if an entity status election (such as a subchapter S election or an election under §301.7701–3(c)) is filed with the IRS but not with the relevant mirror code possession, then the appropriate tax authority of the mirror code possession may, at his or her discretion, deem the election also to have been made for mirror code tax purposes. Similarly, if any such election is filed in a mirror code possession but not with the IRS, the Commissioner may, at his discretion, deem the election to have been made for U.S. Federal income tax purposes. In the event that inconsistent elections are filed with the IRS and the mirror code possession, both the Commissioner and the appropriate tax authority of the mirror code possession may, at their individual discretion, deem the elections they received to be invalid and may deem the election filed with the other jurisdiction to have been made also for tax purposes in their own jurisdiction. Further, in the absence of an election, the default characterization of an eligible entity organized in a mirror code possession shall be determined under the rules applicable to domestic eligible entities under §301.7701–3(b). These consistency rules apply to elections under section 1362(a) and §301.7701–3(c), and to other similar elections. The IRS and Treasury request comments relating to elections that should be specifically mentioned or excluded from the regulations.

These special rules generally apply to elections made after, and entities created after, April 11, 2005. Transition rules are provided for existing entities, under which these special rules generally apply as of the beginning of the next taxable year.

H. *Effective date*

To the extent they provide rules under the operative provisions of the Code relating to the possessions, as amended by 1986 Act and the 2004 Act, these regulations generally apply to taxable years ending after October 22, 2004. The underlying statutory rules, however, generally apply to taxable years beginning after December 31, 1986. Accordingly, taxpayers may rely upon the guidance provided in these regulations with respect to prior years for which the underlying statutory rules are in effect, provided that they do so consistently.

II. *Definitional Provisions*

As indicated above in section I of this explanation, when applying the operative provisions of the Code relating to the possessions, determinations must be made regarding whether an individual is a bona fide resident of a particular possession, or whether income is derived from sources within a particular possession or is effectively connected with the conduct of a trade or business in a particular possession. Section 937 and these regulations provide guidance on these issues, as discussed below.

A. *Bona fide residency in a possession*

The term *bona fide resident* has been an integral part of the special provisions of the Code relating to U.S. possessions since 1950. See sections 220 and 221 of Public Law 81–814. From the beginning, this term has been used to identify the class of persons entitled to Federal tax exemptions or other special treatment under these provisions, and its meaning has remained essentially unchanged through all of the expansions and revisions of these provisions.

Historically, the determination of whether an individual is a bona fide resident of a possession has turned on the facts and circumstances and, specifically, on an individual's intentions with respect to the length and nature of his or her stay in the possession. See, *e.g.*, §§1.933–1(a), 1.934–1(c)(2), and 1.935–1(a)(3) (generally applying the principles of §§1.871–2 through 1.871–5).

But see §301.7701(b)–1(d) (applying the rules of section 7701(b) for determining whether alien individuals qualified as residents of mirror code possessions for taxable years beginning after December 31, 1984). The qualifier "bona fide" indicates that a claim of residence in a possession is respected for Federal tax purposes when it is made in good faith.

As enacted by the 2004 Act, section 937(a) provides that an individual generally will be considered a bona fide resident of a possession only if he or she satisfies all three of the following conditions—

(1) He or she is physically present in the possession for 183 days during the taxable year (physical presence test);

(2) He or she does not have a tax home (determined under the principles of section 911(d)(3) without regard to the second sentence thereof) outside the possession during the taxable year (tax home test); and

(3) He or she 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 the possession (closer connection test).

Section 937(a) further provides that, for purposes of the physical presence test, the determination as to whether a person is present for any day shall be made under the principles of section 7701(b). The legislative history explains that, under this rule, an individual is to be considered present in a possession for a particular day if he is physically present in such possession during any time during such day, and in certain circumstances (*e.g.*, certain medical emergencies), an individual's presence outside a possession is ignored. See H.R. Rep. No. 108–755, at 780 (2004).

The tax home and closer connection tests are similar to the conditions that individuals historically have needed to meet to be considered residents of a possession.

Congress also provided regulatory authority for the IRS and Treasury to create exceptions to this general definition, for cases in which an individual's absence from the possession is motivated by reasons other than tax avoidance. In particular, the legislative history indicates that Congress anticipated that exceptions would be provided for military personnel, workers in the fisheries trade, and retirees who may travel outside of a possession for personal reasons. At the same time, the legislative history makes clear that Congress wished to ensure that individuals who live and work stateside cannot avail themselves of the tax benefits that Congress intended to provide only to individuals who actually reside in the possessions. See H.R. Rep. No. 108–755, at 780 (2004).

Consistent with this legislative history, these regulations include several exceptions to the general statutory rules of section 937(a).

First, these regulations provide several alternatives to the 183-day rule for purposes of satisfying the physical presence test. One alternative is that the individual spend no more than 90 days in the United States during the taxable year. Thus, for example, workers in the fisheries trade who spend considerable periods at sea, and individuals who travel extensively to neighboring islands to provide goods and services, may satisfy the physical presence requirement under this alternative.

Another alternative is that the individual spend more days in the possession than in the United States and have no earned income (as defined in §1.911–3(b)) in the United States during the taxable year. Thus, for example, retirees who spend several months each year stateside for vacation, for medical treatment, or to visit relatives, and some time traveling in foreign countries, may satisfy the physical presence requirement under this alternative.

A final alternative is that the individual have no permanent connection to the United States. For this purpose, the term *permanent connection to the United States* includes a permanent residence and a spouse or dependent with a principal place of abode in the United States. In other words, the absence of a permanent connection will enable an individual to satisfy the physical presence test. Thus, for example, an individual who lives in a possession but travels extensively in the United States for business reasons or to receive medical treatment may satisfy the physical presence requirement under this alternative.

For purposes of determining whether the above-mentioned alternatives are satisfied, certain days spent in the United States are disregarded. In particular, days spent as a full-time student, as a full-time government official or employee of a possession, or as a professional athlete participating in a charitable event generally are disregarded. In addition, days spent in transit and days that an individual is prevented from leaving the United States because of a medical condition that arose while the individual was present in the United States generally will also be disregarded.

The above-mentioned alternatives apply with respect to individuals who are U.S. citizens or resident aliens (as defined in section 7701(b)). A different approach is appropriate in the case of individuals who are nonresident aliens with respect to the United States. For such individuals, in lieu of the above-mentioned alternatives, a mirrored version of the section 7701(b) substantial presence test applies.

For purposes of the tax home test, these regulations provide a special rule for seafarers. Under this special rule, an individual will not be considered to have a tax home outside the relevant possession solely by reason of employment on a ship or other seafaring vessel that is predominantly used in local and international waters.

For purposes of the closer connection test, these regulations provide a special rule under which another possession is not considered a foreign country. Thus, for example, an individual who has a tax home in the USVI and a closer connection to Puerto Rico, and who satisfies the presence test with respect to both possessions, generally will be considered a bona fide resident of the USVI, and not of Puerto Rico.

Special rules apply under Federal law for determining the residence of military personnel for tax purposes. See 50 App. U.S.C. 571(a). Consistent with these special rules, these regulations provide that an individual's absence from or presence in a possession in compliance with military orders generally does not affect whether the individual qualifies as a bona fide resident of such possession.

Finally, consistent with existing law (see Notice 2000–61, 2000–2 C.B. 569), these regulations provide that only natural persons may be considered bona fide residents of a possession for U.S. Federal income tax purposes. Thus, juridical persons such as corporations, partnerships, trusts, and estates cannot be considered bona fide residents of a possession for U.S. Federal income tax purposes.

It should be noted that the 2004 Act modified sections 932 and 935, to conform

the treatment of individuals who acquire or relinquish residency in mirror code possessions with the historical treatment of individuals who acquire or relinquish residency in Puerto Rico and section 931 possessions. Thus, for example, in order to be subject to the special rules of section 932(c), an individual must qualify as a bona fide resident of the USVI during the entire year. Accordingly, an individual generally is not subject to such special rules for any year during which he or she moves to or from the USVI.

The 2004 Act provisions and these regulations as they relate to the determination of bona fide residency in a possession generally apply to taxable years ending after October 22, 2004, except that the physical presence requirement applies only to taxable years beginning after October 22, 2004. In addition, taxpayers may choose to apply the rules set forth in these regulations in their entirety (including the physical presence test) to any open taxable years by notifying the IRS upon examination of their intent to do so. Alternatively, for such years, U.S. citizens and resident alien individuals (as well as nonresident aliens in possessions other than mirror code possessions) may continue to apply the principles of §§1.871–2 through 1.871–5, and nonresident alien individuals in mirror code possessions may continue to apply the rules of §301.7701(b)–1(d) (as in effect for such years).

B. *Income from sources in a possession*

In general, the rules for determining whether income is derived from sources within the United States have applied for purposes of determining whether income is derived from sources within a possession. See §1.863–6. The 2004 Act codified this rule in section 937(b), with two exceptions.

First, section 937(b)(2) (U.S. income rule) provides that an item of income shall not be considered to be derived from sources within a possession (or effectively connected with the conduct of a trade or business within a possession) if such item of income constitutes income from sources within the United States or income effectively connected with the conduct of a trade or business in the United States under the general rules of sections 861 through 865.

Second, section 937(b) provides an express grant of authority, consistent with the authority contained in sections 931, 934, and 957 as amended by the 1986 Act, for Treasury and the IRS to provide appropriate exceptions to the general source rules.

The legislative history to the 2004 Act indicates that Congress intended for Treasury and the IRS to use this authority to continue the existing treatment of income from the sale of goods manufactured in a possession. The 2004 Act legislative history further indicates that Congress intended for this authority to be used to prevent abuse, for example, to prevent U.S. persons from avoiding U.S. tax on appreciated property by acquiring residency in a possession prior to its disposition. See H.R. Rep. No. 108–755, at 781 (2004).

The legislative history to the 1986 Act reflects similar concerns. For example, Congress did not believe that a mainland resident who moves to a possession while owning appreciated personal property such as corporate stock or precious metals and who sells that property in the possession should escape all tax, both in the United States and the possession, on that appreciation. Similarly, Congress did not believe that a resident of a possession who owns financial assets such as stocks or debt of companies organized in, but the underlying value of which is primarily attributable to activities performed outside, the possession should escape tax on the income from those assets. Accordingly, Congress anticipated that regulations would treat such income as sourced outside the possession where the taxpayer resides. See H.R. Rep. No. 99–426, at 487 and 489 (1985); S. Rep. No. 99–313, at 481 and 484 (1986).

These regulations include several exceptions to the general statutory rules of section 937(b).

First, the regulations provide that the U.S. income rule only applies for income earned after December 31, 2004.

Second, the regulations contain a special conduit rule to prevent the avoidance of the U.S. income rule. Under this special conduit rule, income is considered to be from sources within the United States for purposes of the U.S. income rule if, pursuant to a plan or arrangement, (i) the income is received in exchange for consideration provided to another person, and (ii) such person (or another person) provides the same consideration (or consideration of a like kind) to a third person in exchange for one or more payments constituting income from sources within the United States. This rule supplements, and does not supersede, other potentially applicable conduit rules. See, for example, *Aiken Indus., Inc. v. Commissioner*, 56 T.C. 925 (1971). Unlike more generally applicable conduit rules, however, the special conduit rule in these regulations applies only for purposes of section 937 (and provisions for which the rules of section 937 apply); it does not cause the income to be treated as income from sources within the United States for other purposes of the Code.

Third, the regulations preserve the existing treatment of income from the sale of goods manufactured in a possession under §1.863–3(f). These existing rules reflect a careful consideration of the relevant policy considerations arising with respect to the transactions to which they apply, and Congress did not intend for this result to be changed through a mechanical application of the general source rules of section 937(b). For the same reason, these regulations contain rules to preserve the results with respect to the allocation of income between the United States and its possessions under sections 863(c), 863(e), 865(g)(3), and 865(h)(2)(B).

Fourth, the regulations provide special rules for gains from dispositions of certain property held by a U.S. person prior to becoming a resident of a possession. Under these rules, such gains generally are treated as income from sources outside of the possession. These rules supplement, and do not supersede, the special source rule of section 1277(e) of the 1986 Act, which applies to individuals who become residents of Pacific possessions. Under this 1986 Act special source rule, gains from dispositions of certain property held by a U.S. person prior to becoming a resident in a Pacific possession is treated as income from sources within the United States for all purposes of the Code (including section 7654 of the 1954 Code as applicable to Guam and the NMI). The regulations also contain rules that are designed to prevent the avoidance of these special gain rules.

Fifth, the regulations provide special rules for dividends from corporations created or organized in a possession (possessions corporations). In general, such

dividends constitute income from sources within a possession under the principles of section 861(a)(2)(A). A special look-through rule applies, however, when the shareholder owns, directly or indirectly, at least 10 percent of the voting stock of the corporation. Under this special rule, only a ratable portion of any dividend paid or accrued by a possessions corporation to such a shareholder is treated as income from sources within the possession. The ratable portion is determined by applying to the dividend the ratio of the corporation's income from sources within the possession over its total income over a three-year testing period ending with the year in which the dividend is paid. (See also sections 881(b) and 957(c) for which a similar three-year testing period applies.) This look-through rule does not apply, however, if the corporation meets the following conditions (the 80/50 conditions)—

(1) 80 percent or more of the gross income of the corporation for the three-year testing period was derived from sources within the possession or was effectively connected with the conduct of a trade or business in the possession; and

(2) 50 percent or more of the gross income of the corporation for such period was derived from the active conduct of a trade or business within the possession.

Sixth, the regulations provide rules for determining the extent to which income inclusions (for example, under section 951(a)) may be considered to be derived from sources within a possession. Specifically, for shareholders owning at least 10 percent of the voting stock of the corporation, the regulations generally apply the principles of section 904(h)(2), under which the source of income inclusions ordinarily is determined for foreign tax credit purposes. For all other shareholders, income inclusions are considered to be derived from sources within the jurisdiction in which the corporation is created or organized.

Seventh, the regulations provide rules for determining the extent to which interest payments may be considered to be derived from sources within a possession. In general, interest paid by possessions corporations and noncorporate residents of a possession constitutes income from sources within the possession under the principles of section 861(a)(1). A special look-through rule applies, however, when the interest is paid by a possessions corporation to a shareholder who owns, directly or indirectly, at least 10 percent of the voting stock of the corporation. Under this special rule, which is applied in accordance with the principles of §§1.861–9 through 1.861–12, the interest is treated as income from sources within the possession only to the extent that such interest is allocable to assets giving rise to income from sources within the possession or income effectively connected with the conduct of a trade or business within the possession. This look-through rule does not apply, however, if the corporation meets the 80/50 conditions described above. The regulations further provide that interest paid by a partnership is treated as income from sources within a possession only to the extent that such interest is allocable (under the principles of §1.882–5) to income effectively connected with the conduct of a trade or business in the possession.

Special rules apply under Federal law for determining, for tax purposes, the source of income from the performance of services by military personnel. See 50 App. U.S.C. 571(b). Consistent with these special rules, these regulations provide that income from military services performed stateside (or in another possession) by a bona fide resident of a possession is considered to be income from sources within such possession, and income from military services performed in a possession by an individual who is not a bona fide resident of such possession is not considered to be income from sources within such possession.

Lastly, the regulations continue the existing treatment of income from services performed within a possession and from dividends paid by corporations created or organized outside of a possession. Thus, compensation received for services performed in a possession constitutes income from sources within the possession without regard to the *de minimis* exception in section 861(a)(3), and dividends paid by corporations created or organized outside of a possession constitute income from sources outside of the possession in all cases.

The rules of section 937(b) and these regulations generally apply for purposes of all provisions of the Code for which a determination must be made regarding whether income is derived from sources within a possession. They generally do not apply, however, for purposes of applying mirrored provisions of the Code in mirror code possessions. Thus, for example, gain that is treated as income from sources outside the USVI for purposes of section 934(b) under the special gain rules described above (in the paragraph regarding dispositions of certain property held by a U.S. person prior to becoming a resident of a possession), nonetheless may constitute income from sources within the USVI for purposes of mirrored section 904. In addition, in order to avoid unintended reduction of the tax base of mirror code possessions, certain of the special rules described above do not apply for determining whether individuals who are not bona fide residents of such possessions have income from sources within such possessions for purposes of sections 932 and 935.

The 2004 Act provisions concerning the determination of whether income is derived from sources within a possession generally apply to taxable years ending after October 22, 2004, except that the U.S. income rule applies only to income earned after October 22, 2004. The regulations generally adopt these effective dates, except that the regulations provide that the U.S. income rule only applies for income earned after December 31, 2004. Also, the special rules provided for gains from dispositions of certain personal property apply to dispositions after April 11, 2005, and the conduit rule and the look-through rules for dividends and interest from possessions corporations apply to amounts paid or accrued after April 11, 2005. For taxable years beginning after December 31, 1986, and ending before October 23, 2004, the rules of §1.863–6 (as in effect for such years) remain applicable.

C. *Income effectively connected with the conduct of trade or business in a possession*

In 1960, in response to concerns about the reach of a local, tax-related subsidy program, section 934 was enacted to provide explicit limits on the ability of the USVI to reduce income tax liabilities. The legislative history explains that, "while recognizing the desirability of economic development" in the USVI, Congress believed that "in no case should

this be attained by granting windfall gains to taxpayers with respect to income derived from investments in corporations in the continental United States, or with respect to income in any other manner derived from sources outside of the Virgin Islands." S. Rep. No. 1767, 86th Cong., 2nd Sess. 4 (1960).

In 1986, in response to certain identified abuses and other problems related to tax administration in the possessions, section 934 was modified and current section 931 was enacted (among other changes to the rules relating to the possessions). In so doing, Congress expressed concerns similar to those expressed in 1960:

"While the committee believes it is appropriate to provide more local autonomy to these possessions, the committee does not intend to allow them to be used as tax havens. The committee believes that it may be appropriate for these possessions to reduce tax on local income in some cases, but the committee has included antiabuse rules to prevent use of these possessions to avoid U.S. tax. The complexity and ambiguity of the present law rules have provoked taxpayers to take return positions that, while plausible under a literal reading, would result in tax avoidance beyond what taxpayers would ask from this committee or from Congress. The committee is seeking to prevent this in the future." H.R. Rep. No. 99–426, at 485–486 (1985). See also S. Rep. No. 99–313, at 479 (1986).

This concern was also expressed in the legislative history regarding how the IRS and Treasury might exercise their authority under sections 931 and 934 as enacted and modified, respectively, by the 1986 Act, to define the scope of income that would be considered derived from sources within a possession or effectively connected with the conduct of a trade or business in a possession (possession ECI). The discussion in the legislative history was devoted exclusively to ways in which the IRS and Treasury might narrow the scope of these concepts (as compared to the scope they otherwise would have under a mirrored application of the existing principles for determining whether income is considered to be derived from sources within the United States or effectively connected with the conduct of a trade or business in the United States). H.R. Rep. No. 99–426, at 487 and 489 (1985); S. Rep. No. 99–313, at 481 and 484 (1986).

In 2004, in response to certain abusive cases that had been identified, the rules relating to the possessions were again modified. In so doing, Congress once again expressed its concern about how such rules might be used as an inappropriate means to reduce U.S. taxes: "The conferees are further concerned that the general rules for determining whether income is effectively connected with the conduct of a trade or business in a possession present numerous opportunities for erosion of the U.S. tax base." H.R. Rep. No. 108–755, at 780 (2004). The U.S. income rule discussed above (see section II.B. of this explanation) was enacted in order to prevent such U.S. tax avoidance.

Reflecting the concern that tax benefits intended to foster economic development in the possessions should not be permitted to be used as a means to reduce U.S. taxes on income derived from U.S. economic activity, these regulations incorporate the U.S. income rule of section 937(b)(2), as well as a conduit rule (as described above in section II.B. of this explanation) that is intended to prevent the avoidance of the U.S. income rule. Accordingly, income from U.S. sources generally will not be considered possession ECI.

Section 937(b) also includes regulatory authority for the IRS and Treasury to provide exceptions to this rule. As noted above in section II.B. of this explanation, the legislative history to the 2004 Act indicates that Congress intended for Treasury and the IRS to use this authority to continue the existing treatment of income from the sale of goods manufactured in a possession. Accordingly, these regulations provide an exception from the U.S. income rule for such income. In addition, the regulations provide that the U.S. income rule only applies for income earned after December 31, 2004.

Apart from the U.S. income rule, these regulations apply the same principles for determining whether income is possession ECI as have applied since the 1986 Act. See *Francisco v. Commissioner*, 119 T.C. 317 (2002) aff'd, 370 F.3d 1228 (D.C. Cir. 2004) (principles of section 864(c)(4) apply for determining whether U.S. source income is possession ECI for U.S. Federal income tax purposes).

The rules of section 937(b) and these regulations generally apply for purposes of all provisions of the Code for which a determination must be made regarding whether income is possession ECI. They generally do not apply, however, for purposes of applying mirrored provisions of the Code in mirror code possessions. Thus, for example, U.S. source income that is treated as income not effectively connected with the conduct of a trade or business within the USVI for purposes of section 934(b) under the U.S. income rule described above nonetheless may constitute income effectively connected with the conduct of a trade or business within the USVI for purposes of mirrored section 871 or 882.

The 2004 Act provisions concerning the determination of whether income is possession ECI generally apply to taxable years ending after October 22, 2004, except that the U.S. income rule applies only to income earned after October 22, 2004. The regulations generally adopt these effective dates, except that the regulations provide that the U.S. income rule only applies for income earned after December 31, 2004. In addition, the conduit rule applies only to amounts paid or accrued after April 11, 2005. For taxable years beginning after December 31, 1986, and ending before October 23, 2004, the principles of section 864(c) (including section 864(c)(4)) remain applicable.

III. *Information Reporting by Residents of a Possession*

Section 7654(e), as enacted by the 1972 Act and still applicable with respect to section 935 possessions, provides an express grant of authority for the IRS and Treasury to issue regulations prescribing information reporting requirements for individuals to whom section 935 applies, as necessary to carry out the provisions of sections 935 and 7654. Section 7654(e), as amended by the 1986 Act, provides a similar express grant of authority for the IRS and Treasury to issue regulations prescribing information reporting requirements for individuals to whom sections 931 and 932 apply, as necessary to carry out the provisions of those sections and section 7654. The penalty provided under section 6688, as amended by the 2004 Act, for failure

to satisfy such reporting requirements is $1,000.

The 2004 Act supplemented this general grant of authority with a specific requirement under section 937(c) for information reporting by individuals who take the position for U.S. income tax reporting purposes that they became, or ceased to be, bona fide residents of Guam, American Samoa, the NMI, Puerto Rico, or the USVI. For taxable years ending after October 22, 2004, as well as for any of an individual's preceding three taxable years, section 937(c) requires that such individuals provide notice of their change in residency. Thus, for calendar year taxpayers, such information reporting generally is required if they changed their residency to or from a possession during 2001, 2002, 2003, or 2004 (or if they do so in any future year).

Section 937(c) authorizes the IRS and Treasury to prescribe the time and manner by which taxpayers are to provide such notice. In early 2005, the IRS will provide a form on which the notice required by section 937(c) is to be made, as well as instructions specifying the time and manner for filing the form. The IRS and Treasury anticipate issuing guidance that will provide appropriate exceptions to the general statutory rules in order to minimize the reporting burden on taxpayers. Reporting will not be required until the form and instructions are made available. The same $1,000 penalty under section 6688 will apply in cases of failure to file this form when required.

IV. *Removal of Obsolete Regulations*

This document also removes certain regulations, and cross-references to such regulations, which became obsolete with the enactment of the 1986 Act. The 1986 Act amendments that rendered them obsolete were effective for tax years beginning after December 31, 1986. For example, the regulations promulgated by T.D. 6500, 25 FR 11910; T.D. 7283, 1973–2 C.B. 79 [38 FR 20825}; and T.D. 7385, 1975–2 C.B. 298 [40 FR 50260], relating to former section 931, were rendered obsolete with the enactment of the 1986 Act. Thus, such regulations have no legal effect for taxable years beginning after December 31, 1986. See, *e.g.*, *Specking v. Commissioner*, 117 T.C. 95 (2001), aff'd sub nom. *Umbach v. Commissioner*, 357 F.3d 1108 (10th Cir. 2004).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are W. Edward Williams and J. David Varley, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.931–1T also issued under 26 U.S.C. 7654(e).

Section 1.932–1T also issued under 26 U.S.C. 7654(e).

Section 1.935–1T also issued under 26 U.S.C. 7654(e). * * *

Section 1.937–1T also issued under 26 U.S.C. 937(a).

Section 1.937–2T also issued under 26 U.S.C. 937(b).

Section 1.937–3T also issued under 26 U.S.C. 937(b). * * *

Section 1.957–3T also issued under 26 U.S.C. 957(c). * * *

Par. 2. In §1.170A–1, paragraph (j)(9) is revised to read as follows:

§1.170A–1 Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(j)(9) [Reserved]. For further guidance, see §1.170A–1T(j)(9).

* * * * *

Par. 3. Section 1.170A–1T is added to read as follows:

§1.170A–1T Charitable, etc., contributions and gifts; allowance of deduction (temporary).

(a) through (j)(8) [Reserved]. For further guidance, see §1.170A–1(a) through (j)(8).

(j)(9) Charitable contributions paid by bona fide residents of a section 931 possession as defined in §1.931–1T(c)(1) or Puerto Rico are deductible only to the extent allocable to income that is not excluded under section 931 or 933. For the rules for allocating deductions for charitable contributions, see the regulations under section 861.

(j)(10) and (11) [Reserved]. For further guidance, see §1.170–1(j)(10) and (11).

(k) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 4. In §1.243–3, paragraph (a)(2)(iii) is revised to read as follows:

§1.243–3 Certain dividends from foreign corporations.

* * * * *

(a)(2) * * *

(iii) by a domestic corporation during any period to which section 931 (relating to income from sources within possessions of the United States), as in effect for taxable years beginning before January 1, 1976, applied.

Par. 5. In §1.702–1, paragraph (c)(1)(iii) is revised to read as follows:

§1.702–1 Income and credits of partner.

* * * * *

(c)(1) * * *

(iii) In computing the amount of gross income received from sources within possessions of the United States (section 937).

* * * * *

Par. 6. In §1.861–3, paragraph (a)(2) is revised to read as follows:

§1.861–3 Dividends.

* * * * *

(a)(2) [Reserved]. For further guidance, see §1.861–3T(a)(2).

Par. 7. Section 1.861–3T is added to read as follows:

§1.861–3T Dividends (temporary).

(a)(1) [Reserved]. For further guidance, see §1.861–3(a)(1).

(2) *Dividend from a domestic corporation*. A dividend described in this paragraph (a)(2) is a dividend from a domestic corporation other than a corporation which has an election in effect under section 936. See paragraph (a)(5) of this section for the treatment of certain dividends from a DISC or former DISC.

(a)(3) through (c) [Reserved]. For further guidance, see §1.861–3(a)(3) through (c).

(d) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 8. In §1.861–8, paragraphs (f)(1)(vi)(E), (F), and (H) are revised to read as follows:

§1.861–8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(f) * * *

(1) * * *

(vi) * * *

(E) [Reserved].

(F) [Reserved].

* * * * *

(H) [Reserved].

* * * * *

Par. 9. Section 1.863–6 is revised to read as follows:

§1.863–6 Income from sources within a foreign country.

The principles applied in sections 861 through 863 and section 865 and the regulations thereunder for determining the gross and the taxable income from sources within and without the United States shall generally be applied in determining the gross and the taxable income from sources within and without a particular foreign country when such a determination must be made under any provision of Subtitle A of the Internal Revenue Code, including section 952(a)(5). This section shall not apply, however, to the extent it is determined by applying §1.863–3 that a portion of the taxable income is from sources within the United States and the balance of the taxable income is from sources within a foreign country. In the application of this section, the name of the particular foreign country shall be used instead of the term *United States*, and the term *domestic* shall be construed to mean created or organized in such foreign country. In applying section 861 and the regulations thereunder for purposes of this section, references to sections 243 and 245 shall be excluded, and the exception in section 861(a)(3) shall not apply. In the case of any item of income, the income from sources within a foreign country shall not exceed the amount which, by applying any provision of sections 861 through 863 and section 865 and the regulations thereunder without reference to this section, is treated as income from sources without the United States. See §1.937–2T for rules for determining income from sources within a possession of the United States.

Par. 10. Section 1.871–1 is amended by:

1. Removing paragraph (b)(6).

2. Redesignating paragraph (b)(7) as (b)(6).

Par. 11. Section 1.876–1 is revised to read as follows:

§1.876–1 Alien residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

[Reserved]. For further guidance, see §1.876–1T.

Par. 12. Section 1.876–1T is added to read as follows:

§1.876–1T Alien residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands (temporary).

(a) *Scope*. Section 876 and this section apply to any nonresident alien individual who is a bona fide resident of Puerto Rico or of a section 931 possession during the entire taxable year.

(b) *In general*. An individual to whom this section applies is, in accordance with the provisions of section 876, subject to tax under sections 1 and 55 in generally the same manner as an alien resident of the United States. See §§1.1–1(b) and 1.871–1. The tax generally is imposed upon the taxable income of such individual, determined in accordance with section 63(a) and the regulations thereunder, from sources both within and without the United States, except for amounts excluded from gross income under the provisions of section 931 or 933. For determining the form of return to be used by such an individual, see section 6012 and the regulations thereunder.

(c) *Exceptions*. Though subject to the tax imposed by section 1, an individual to whom this section applies shall nevertheless be treated as a nonresident alien individual for the purpose of many provisions of the Internal Revenue Code relating to nonresident alien individuals. Thus, for example, such an individual is not allowed the standard deduction (section 63(c)(6)); is subject to withholding of tax at source under chapter 3 of the Internal Revenue Code (*e.g.*, section 1441(e)); is generally excepted from the collection of income tax at source on wages for services performed in the possession (section 3401(a)(6)); is not allowed to make a joint return (section 6013(a)(1)); and, if described in section 6072(c), must pay his first installment of estimated income tax on or before the 15th day of the 6th month of the taxable year (section 6654(j) and (k)) and must pay his income tax on or before the 15th day of the 6th month following the close of the taxable year (sections 6072(c) and 6151(a)). In addition, under section 152(b)(3), an individual is not allowed a deduction for a dependent who is a resident of the relevant possession unless the dependent is a citizen or national of the United States.

(d) *Credits against tax*— (1) Certain credits under the Internal Revenue Code are available to any taxpayer subject to the tax imposed by section 1, including individuals to whom this section applies. For example, except as otherwise provided under section 931 or 933, the credits provided by the following sections are allowable to the extent provided under such sec-

tions against the tax determined in accordance with this section—

(i) Section 23 (relating to the credit for adoption expenses);

(ii) Section 31 (relating to the credit for tax withheld on wages);

(iii) Section 33 (relating to the credit for tax withheld at source on nonresident aliens); and

(iv) Section 34 (relating to the credit for certain uses of gasoline and special fuels).

(2) Certain credits under the Internal Revenue Code are not available to nonresident aliens or are subject to limitations based on such factors as principal place of abode in the United States. For example, the credits provided by the following sections are not allowable against the tax determined in accordance with this section except to the extent otherwise provided under such sections—

(i) Section 22 (relating to the credit for the elderly and disabled);

(ii) Section 25A (relating to the Hope Scholarship and Lifetime Learning Credits); and

(iii) Section 32 (relating to the earned income credit).

(e) *Definitions*. For purposes of this section:

(1) *Bona fide resident* is defined in §1.937–1T.

(2) *Section 931 possession* is defined in §1.931–1T(c)(1).

(f) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 13. In §1.881–1(c), revise the third and fourth sentences to read as follows:

§1.881–1 Manner of taxing foreign corporations.

* * * * *

(c) * * * The term *foreign corporation* has the meaning assigned to it by section 7701(a)(3) and (5) and the regulations thereunder. However, for special rules relating to possessions of the United States, see §1.881–5T.

* * * * *

Par. 14. Section 1.881–5T is added to read as follows:

§1.881–5T Exception for certain possessions corporations (temporary).

(a) *Scope*. Section 881(b) and this section provide special rules for the application of sections 881 and 884 to certain corporations created or organized in possessions of the United States. Paragraph (g) of this section provides special rules for the application of sections 881 and 884 to corporations created or organized in the United States for purposes of determining tax liability incurred to certain possessions that administer income tax laws that are identical (except for the substitution of the name of the possession for the term *United States* where appropriate) to those in force in the United States. See §1.884–0T(b) for special rules relating to the application of section 884 with respect to possessions of the United States.

(b) *Operative rules*. (1) Corporations described in paragraphs (c) and (d) of this section are not treated as foreign corporations for purposes of section 881. Accordingly, they are exempt from the tax imposed by section 881(a).

(2) For corporations described in paragraph (e) of this section, the rate of tax imposed by section 881(a) on U.S. source dividends received is 10 percent (rather than the generally applicable 30 percent).

(c) *U.S.V.I. and section 931 possessions*. A corporation created or organized in, or under the law of, the United States Virgin Islands or a section 931 possession is described in this paragraph (c) for a taxable year when the following conditions are satisfied—

(1) At all times during such taxable year, less than 25 percent in value of the stock of such corporation is beneficially owned (directly or indirectly) by foreign persons;

(2) At least 65 percent of the gross income of such corporation is shown to the satisfaction of the Commissioner upon examination to be effectively connected with the conduct of a trade or business in such a possession or the United States for the 3-year period ending with the close of the taxable year of such corporation (or for such part of such period as the corporation or any predecessor has been in existence); and

(3) No substantial part of the income of such corporation for the taxable year is used (directly or indirectly) to satisfy obligations to persons who are not bona fide residents of such a possession or the United States.

(d) *Section 935 possessions*. A corporation created or organized in, or under the law of, a section 935 possession is described in this paragraph (d) for a taxable year when the following conditions are satisfied—

(1) At all times during such taxable year, less than 25 percent in value of the stock of such corporation is owned (directly or indirectly) by foreign persons; and

(2) At least 20 percent of the gross income of such corporation is shown to the satisfaction of the Commissioner upon examination to have been derived from sources within such possession for the 3-year period ending with the close of the preceding taxable year of such corporation (or for such part of such period as the corporation has been in existence).

(e) *Puerto Rico*. A corporation created or organized in, or under the law of, Puerto Rico is described in this paragraph (e) for a taxable year when the conditions of paragraphs (c)(1) through (3) are satisfied (using the language "Puerto Rico" instead of "such a possession").

(f) *Definitions and other rules*. For purposes of this section:

(1) *Section 931 possession* is defined in §1.931–1T(c)(1).

(2) *Section 935 possession* is defined in §1.935–1T(a)(3)(i).

(3) *Foreign person* means any person other than—

(i) A United States person (as defined in section 7701(a)(30) and the regulations thereunder); or

(ii) A person who would be a United States person if references to the United States in section 7701 included references to a possession of the United States.

(4) *Bona fide resident* —

(i) With respect to a possession, is defined in §1.937–1T; and

(ii) With respect to the United States, means an individual who is a citizen or resident of the United States and who does not have a tax home (as defined in section 911(d)(3)) in a foreign country.

(5) *Source*. The rules of §1.937–2T shall apply for determining whether income is from sources within a possession.

(6) *Effectively connected income*. The rules of §1.937–3T (other than paragraph

(c) of that section) shall apply for determining whether income is effectively connected with the conduct of a trade or business in a possession.

(7) *Indirect ownership*. The rules of section 318(a)(2) shall apply except that the language "5 percent" shall be used instead of "50 percent" in section 318(a)(2)(C).

(g) *Mirror code jurisdictions*. For purposes of applying mirrored section 881 to determine tax liability incurred to a section 935 possession or the United States Virgin Islands—

(1) The rules of paragraphs (b) through (d) of this section shall not apply; and

(2) A corporation created or organized in, or under the law of, such possession or the United States shall not be considered a foreign corporation.

(h) *Example*. The principles of this section are illustrated by the following example:

Example 1. X is a corporation organized under the law of the United States Virgin Islands (USVI) with a branch located in State F. At least 65 percent of the gross income of X is effectively connected with the conduct of a trade or business in the USVI and no substantial part of the income of X for the taxable year is used to satisfy obligations to persons who are not bona fide residents of the United States or the USVI. Seventy-four percent of the stock of X is owned by unrelated individuals who are residents of the United States or the USVI. Y, a corporation organized under the law of State D, and Z, a partnership organized under the law of State F, each own 13 percent of the stock of X. A, an unrelated foreign individual, owns 100 percent of the stock of corporation Y. B and C, unrelated foreign individuals, each own a 50 percent interest in partnership Z. Thus, the condition of paragraph (c)(1) of this section is not satisfied, because 26 percent of X is owned indirectly by foreign persons (A, B, and C). Accordingly, X is treated as a foreign corporation for purposes of section 881.

(i) *Effective dates*. Except as provided in this paragraph (i), this section applies to payments made after April 11, 2005. The rules of paragraphs (b)(2) and (e) apply to dividends paid after October 22, 2004. However, if, on or after October 22, 2004, an increase in the rate of the Commonwealth of Puerto Rico's withholding tax which is generally applicable to dividends paid to United States corporations not engaged in a trade or business in the Commonwealth to a rate greater than 10 percent takes effect, the rules of paragraphs (b)(2) and (e) shall not apply to dividends received on or after the effective date of the increase.

Par. 15. In §1.884–0, paragraph (b) is redesignated as paragraph (c), and a new paragraph (b) is added.

The addition reads as follows:

§1.884–0 Overview of regulation provisions for section 884.

* * * * *

(b) *Special rules for U.S. possessions*. [Reserved]. For further guidance, see §1.884–0T(b).

* * * * *

Par. 16. Section 1.884–0T is added as follows.

§1.884–0T Overview of regulation provisions for section 884 (temporary).

(a) [Reserved]. For further guidance, see §1.884–0(a).

(b) *Special rules for U.S. possessions*. (1) Section 884 does not apply to a corporation created or organized in, or under the law of, American Samoa, Guam, the Northern Mariana Islands, or the United States Virgin Islands, provided that the conditions of §1.881–5T(c)(1) through (3) are satisfied with respect to such corporation. The preceding sentence applies for taxable years ending after April 11, 2005.

(2) Section 884 does not apply for purposes of determining tax liability incurred to a section 935 possession or the United States Virgin Islands by a corporation created or organized in, or under the law of, such possession or the United States. The preceding sentence applies for taxable years ending after April 11, 2005.

(c) [Reserved]. For further guidance, see §1.884–0(c).

Par. 17. In §1.901–1, paragraph (g) is revised to read as follows:

§1.901–1 Allowance of credit for taxes.

* * * * *

(g) [Reserved]. For further guidance, see §1.901–1T(g).

* * * * *

Par. 18. Section 1.901–1T is added to read as follows:

§1.901–1T Allowance of credit for taxes (temporary).

(a) through (f) [Reserved]. For further guidance, see §1.901–1(a) through (f).

(g) *Taxpayers to whom credit not allowed*. Among those to whom the credit for taxes is not allowed are the following—

(1) Except as provided in section 906, a foreign corporation;

(2) Except as provided in section 906, a nonresident alien individual who is not described in section 876 (see sections 874(c) and 901(b)(4));

(3) A nonresident alien individual described in section 876 other than a bona fide resident (as defined in section 937(a) and the regulations thereunder) of Puerto Rico during the entire taxable year (see sections 901(b)(3) and (4)); and

(4) A U.S. citizen or resident alien individual who is a bona fide resident of a section 931 possession (as defined in §1.931–1T(c)(1)), the U.S. Virgin Islands, or Puerto Rico, and who excludes certain income from U.S. gross income to the extent of taxes allocable to the income so excluded (see sections 931(b)(2), 933(1), and 932(c)(4)).

(h) [Reserved]. For further guidance, see §1.901–1(h).

(i) [Reserved]. For further guidance, see §1.901–1(i).

(j) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 19. Section 1.931–1 is revised to read as follows:

§1.931–1 Exclusion of certain income from sources within Guam, American Samoa, or the Northern Mariana Islands.

[Reserved]. For further guidance, see §1.931–1T.

Par. 20. Section 1.931–1T is added to read as follows:

§1.931–1T Exclusion of certain income from sources within Guam, American Samoa, or the Northern Mariana Islands (temporary).

(a) *General rule*. (1) An individual (whether a United States citizen or an alien), who is a bona fide resident of a section 931 possession during the entire taxable year, shall exclude from gross income the income derived from sources within any section 931 possession and the income effectively connected with the conduct of a trade or business by such individual within any section 931 possession, except amounts received for services

performed as an employee of the United States or any agency thereof.

(2) The following example illustrates the application of the general rule in paragraph (a)(1) of this section:

Example. D, a United States citizen, files returns on a calendar year basis. In April 2005, D moves to American Samoa, purchases a house, and accepts a permanent position with a local employer. For the remainder of the year and throughout 2006, D continues to live and work in American Samoa, and establishes a closer connection to American Samoa than to the United States or any foreign country. In September 2007, as a result of the termination of his employment in American Samoa, D sells his house and moves to State H. D is entitled to the exclusion provided in section 931 for 2006, but not for 2005 or 2007 (assuming that during the first quarter of 2005 and the last quarter of 2007, D has a tax home outside of American Samoa or a closer connection to the United States or a foreign country).

(b) *Deductions and credits*. In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 931, there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions (except the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to, or chargeable against, the amounts so excluded from gross income. For purposes of the preceding sentence, the rules of §1.861–8 shall apply (with creditable expenditures treated in the same manner as deductible expenditures).

(c) *Definitions*. For purposes of this section:

(1) The term *section 931 possession* means a possession that is a specified possession and that has entered into an implementing agreement, as described in section 1271(b) of the Tax Reform Act of 1986 (Public Law 99–514 (100 Stat. 2085)), with the United States that is in effect for the entire taxable year.

(2) The term *specified possession* means Guam, American Samoa, or the Northern Mariana Islands.

(3) The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of a section 931 possession.

(4) The rules of §1.937–2T shall apply for determining whether income is from sources within a section 931 possession.

(5) The rules of §1.937–3T shall apply for determining whether income is effectively connected with the conduct of a trade or business within a section 931 possession.

(d) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 21. Section 1.932–1 is revised to read as follows:

§1.932–1 Coordination of United States and Virgin Islands income taxes.

[Reserved]. For further guidance, see §1.932–1T.

Par. 22. Section 1.932–1T is added to read as follows:

§1.932–1T Coordination of United States and Virgin Islands income taxes (temporary).

(a) *Scope*— (1) *In general*. Section 932 and this section set forth the special rules relating to the filing of income tax returns and income tax liabilities of individuals described in paragraph (a)(2) of this section. Paragraph (h) of this section also provides special rules requiring consistent treatment of business entities in the United States and in the United States Virgin Islands (Virgin Islands).

(2) *Individuals covered*. This section shall apply to any individual who:

(i) Is a bona fide resident of the Virgin Islands during the entire taxable year;

(ii)(A) Is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands) during the entire taxable year; and

(B) Has income derived from sources within the Virgin Islands, or effectively connected with the conduct of a trade or business within the Virgin Islands, for the taxable year; or

(iii) Files a joint return for the taxable year with any individual described in paragraph (a)(2)(i) or (ii) of this section.

(3) *Definitions*. For purposes of this section:

(i) The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of the Virgin Islands.

(ii) The rules of §1.937–2T shall apply for determining whether income is from sources within the Virgin Islands.

(iii) The rules of §1.937–3T shall apply for determining whether income is effectively connected with the conduct of a trade or business within the Virgin Islands.

(b) *U.S. individuals with V.I. income*— (1) *Dual filing requirement*. Subject to paragraph (d) of this section, an individual described in paragraph (a)(2)(ii) of this section shall make an income tax return for the taxable year to the United States and file a copy of such return with the Virgin Islands. Such individuals must also attach Form 8689, "*Allocation of Individual Income Tax to the Virgin Islands*," to the U.S. income tax return and to the income tax return filed with the Virgin Islands.

(2) *Tax payments*. (i) Each individual to whom this paragraph (b) 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 (b)(2)(ii) of this section) to the Virgin Islands.

(ii) 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 (b)(2)(i) of this section which are so paid. Such taxes shall be considered creditable in the same manner as taxes paid to the United States (*e.g.*, under section 31) and not as taxes paid to a foreign government (*e.g.*, under sections 27 and 901).

(iii) For purposes of this paragraph (b)(2):

(A) The term *applicable percentage* means the percentage which Virgin Islands adjusted gross income bears to adjusted gross income.

(B) 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. For purposes of the preceding sentence, the rules of §1.861–8 shall apply.

(C) Pursuant to §1.937–2T(a), the rules of §1.937–2T(c)(1)(ii) and (c)(2) do not apply.

(c) *Bona fide residents of the Virgin Islands*. Subject to paragraph (d) of this section, an individual described in paragraph (a)(2)(i) of this section shall be subject to the following income tax return filing requirements:

(1) *V.I. filing requirements*. An individual to whom this paragraph (c) applies shall file an income tax return for the taxable year with the Virgin Islands. On this return, the individual shall report income

from all sources and identify the source of each item of income shown on the return.

(2) *U.S. filing requirements*. For purposes of calculating the income tax liability to the United States of an individual to whom this paragraph (c) applies, gross income shall not include any amount included in gross income on the return filed with the Virgin Islands pursuant to paragraph (c)(1) of this section, and deductions and credits allocable to such income shall not be taken into account, provided that—

(i) The individual fully satisfied the reporting requirements of paragraph (c)(1) of this section; and

(ii) The individual fully paid the tax liability referred to in section 934(a) to the Virgin Islands with respect to such income.

(d) *Joint returns*. In the case of married persons, if one or both spouses is an individual described in paragraph (a)(2) of this section and they file a joint return of income tax, the spouses shall file their joint return with, and pay the tax due on such return to, the jurisdiction (or jurisdictions) where the spouse who has the greater adjusted gross income for the taxable year would be required under paragraph (b) or (c) of this section to file a return if separate returns were filed and all of their income were the income of such spouse. For this purpose, adjusted gross income of each spouse is determined under section 62 and the regulations thereunder but without regard to community property laws; and, if one of the spouses dies, the taxable year of the surviving spouse shall be treated as ending on the date of such death.

(e) *Place for filing returns*— (1) *U.S. returns*. A return required under the rules of paragraphs (b) and (c) of this section to be filed with the United States shall be filed as directed in the applicable forms and instructions.

(2) *V.I. returns*. A return required under the rules of paragraphs (b) and (c) of this section to be filed with the Virgin Islands shall be filed as directed in the applicable forms and instructions.

(f) *Tax accounting standards*— (1) *In general*. A dual filing taxpayer must use the same tax accounting standards on the returns filed with the United States and the Virgin Islands. A taxpayer who has filed a return only with the United States or only with the Virgin Islands as a single filing taxpayer for a prior taxable year and is required to file a return only with the other jurisdiction as a single filing taxpayer for a later taxable year may not, for such later taxable year, use different tax accounting standards unless the second jurisdiction consents to such change. However, such change will not be effective for returns filed thereafter with the first jurisdiction unless before such later date of filing the taxpayer also obtains the consent of the first jurisdiction to make such change. Any request for consent to make a change pursuant to this paragraph (f) must be made to the office where the return is required to be filed under paragraph (e) of this section and in sufficient time to permit a copy of the consent to be attached to the return for the taxable year.

(2) *Definitions*. For purposes of this paragraph (f):

(i) The term *dual filing taxpayer* means a taxpayer who is required to file returns with the United States and the Virgin Islands for the same taxable year under the rules of paragraph (b) or (c) of this section.

(ii) The term *single filing taxpayer* means a taxpayer who is required to file a return only with the United States (because the individual is not described in paragraph (a)(2) of this section) or only with the Virgin Islands (because the individual is described in paragraph (a)(2)(i) of this section and satisfies the conditions of paragraphs (c)(2)(i) and (ii) of this section) for the taxable year.

(iii) The term *tax accounting standards* includes the taxpayer's accounting period, methods of accounting, and any election to which the taxpayer is bound with respect to the reporting of taxable income.

(g) *Extension of territory*— (1) *Section 932(a) taxpayers*— (i) *General rule*. With respect to an individual to whom section 932(a) applies for a taxable year, for purposes of taxes imposed by Chapter 1 of the Internal Revenue Code, the United States generally shall be treated, in a geographical and governmental sense, as including the Virgin Islands. The purpose of this rule is to facilitate the coordination of the tax systems of the United States and the Virgin Islands. Accordingly, the rule will have no effect where it is manifestly inapplicable or its application would be incompatible with the intent of any provision of the Internal Revenue Code.

(ii) *Application of general rule*. Contexts in which the general rule of paragraph (g)(1)(i) of this section apply include:

(A) The characterization of taxes paid to the Virgin Islands. An individual to whom section 932(a) applies may take income tax required to be paid to the Virgin Islands under section 932(b) into account under sections 31, 6315, and 6402(b) as payments to the United States. Taxes paid to the Virgin Islands and otherwise satisfying the requirements of section 164(a) will be allowed as a deduction under that section, but income taxes required to be paid to the Virgin Islands under section 932(b) will be disallowed as a deduction under section 275(a).

(B) The determination of the source of income for purposes of the foreign tax credit (*e.g.*, sections 901 through 904). Thus, for example, after an individual to whom section 932(a) applies determines which items of income constitute income from sources within the Virgin Islands under the rules of section 937(b), such income shall be treated as income from sources within the United States for purposes of section 904.

(C) The eligibility of a corporation to make a subchapter S election (sections 1361 through 1379). Thus, for example, for purposes of determining whether a corporation created or organized in the Virgin Islands may make an election under section 1362(a) to be a subchapter S corporation, it shall be treated as a domestic corporation and a shareholder to whom section 932(a) applies shall not be treated as a nonresident alien individual with respect to such corporation. While such an election is in effect, the corporation shall be treated as a domestic corporation for all purposes of the Internal Revenue Code. For the consistency requirement with respect to entity status elections, see paragraph (h) of this section.

(D) The treatment of items carried over from other tax years. Thus, for example, if an individual to whom section 932(a) applies has for a taxable year a net operating loss carryback or carryover under section 172, a foreign tax credit carryback or carryover under section 904, a business credit carryback or carryover under section 39, a capital loss carryover under section 1212, or a charitable contributions carryover under section 170, the carryback or carryover will be reported on the return filed in accordance with paragraph (b)(1) of this section, even though the return of the taxpayer for the taxable year giving rise to the

carryback or carryover was required to be filed with the Virgin Islands under section 932(c).

(E) The treatment of property exchanged for property of a like kind (section 1031). Thus, for example, if an individual to whom section 932(a) applies exchanges real property located in the United States for real property located in the Virgin Islands, notwithstanding the provisions of section 1031(h), such exchange may qualify as a like-kind exchange under section 1031 (provided that all the other requirements of section 1031 are satisfied).

(iii) *Nonapplication of the general rule*. Contexts in which the general rule of paragraph (g)(1)(i) of this section does not apply include:

(A) The application of any rules or regulations that explicitly treat the United States and any (or all) of its possessions as separate jurisdictions (*e.g.*, sections 931 through 937, 7651, and 7654).

(B) The determination of any aspect of an individual's residency (*e.g.*, sections 937(a) and 7701(b)). Thus, for example, an individual whose principal place of abode is in the Virgin Islands is not considered to have a principal place of abode in the United States for purposes of section 32(c).

(C) The characterization of a corporation for purposes other than subchapter S (*e.g.*, sections 367, 951 through 964, 1291 through 1298, 6038, and 6038B). Thus, for example, if an individual to whom section 932(a) applies transfers appreciated tangible property to a corporation created or organized in the Virgin Islands in a transaction described in section 351, he or she must recognize gain unless an exception under section 367(a) applies. Also, if a corporation created or organized in the Virgin Islands qualifies as a passive foreign investment company under sections 1297 and 1298 with respect to an individual to whom section 932(a) applies, a dividend paid to such shareholder does not constitute qualified dividend income under section 1(h)(11)(B).

(2) *Section 932(c) taxpayers*— (i) *General rule*. With respect to an individual to whom section 932(c) applies for a taxable year, for purposes of the territorial income tax of the Virgin Islands (*i.e.*, mirrored sections of the Internal Revenue Code), the Virgin Islands generally shall be treated, in a geographical and governmental sense, as including the United States. The purpose of this rule is to facilitate the coordination of the tax systems of the United States and the Virgin Islands. Accordingly, the rule will have no effect where it is manifestly inapplicable or its application would be incompatible with the intent of any provision of the Internal Revenue Code.

(ii) *Application of general rule*. Contexts in which the general rule of paragraph (g)(2)(i) of this section apply include:

(A) The characterization of taxes paid to the United States. A taxpayer described in section 932(c)(1) may take income tax paid to the United States into account under mirrored sections 31, 6315, and 6402(b) as payments to the Virgin Islands.

(B) The determination of the source of income for purposes of the foreign tax credit (*e.g.*, mirrored sections 901 through 904). Thus, for example, any item of income that constitutes income from sources within the United States under the rules of sections 861 through 865 shall be treated as income from sources within the Virgin Islands for purposes of mirrored section 904.

(C) The eligibility of a corporation to make a subchapter S election (mirrored sections 1361 through 1379). Thus, for example, for purposes of determining whether a corporation created or organized in the United States may make an election under mirrored section 1362(a) to be a subchapter S corporation, it shall be treated as a domestic corporation and a shareholder to whom section 932(c) applies shall not be treated as a nonresident alien individual with respect to such corporation. While such an election is in effect, the corporation shall be treated as a domestic corporation for all purposes of the territorial income tax. For the consistency requirement with respect to entity status elections, see paragraph (h) of this section.

(D) The treatment of items carried over from other tax years. Thus, for example, if an individual to whom section 932(c) applies has for a taxable year a net operating loss carryback or carryover under mirrored section 172, a foreign tax credit carryback or carryover under mirrored section 904, a business credit carryback or carryover under mirrored section 39, a capital loss carryover under mirrored section 1212, or a charitable contributions carryover under mirrored section 170, the carryback or carryover will be reported on the return filed in accordance with paragraph (c)(1) of this section, even though the return of the taxpayer for the taxable year giving rise to the carryback or carryover was required to be filed with the United States.

(E) The treatment of property exchanged for property of a like kind (mirrored section 1031). Thus, for example, if an individual to whom section 932(c) applies exchanges real property located in the United States for real property located in the Virgin Islands, notwithstanding the provisions of mirrored section 1031(h), such exchange may qualify as a like-kind exchange under mirrored section 1031 (provided that all the other requirements of mirrored section 1031 are satisfied).

(iii) *Nonapplication of general rule*. Contexts in which the general rule of paragraph (g)(2)(i) of this section does not apply include:

(A) The determination of any aspect of an individual's residency (*e.g.*, mirrored section 7701(b)). Thus, for example, an individual whose principal place of abode is in the United States is not considered to have a principal place of abode in the Virgin Islands for purposes of mirrored section 32(c).

(B) The determination of the source of income for purposes other than the foreign tax credit (*e.g.*, sections 932(a) and (b), 934(b), and 937). Thus, for example, compensation for services performed in the United States and rentals or royalties from property located in the United States do not constitute income from sources within the Virgin Islands for purposes of section 934(b).

(C) The definition of wages (mirrored section 3401). Thus, for example, services performed by an employee for an employer in the United States do not constitute services performed in the Virgin Islands under mirrored section 3401(a)(8).

(h) *Entity status consistency requirement*— (1) *In general*. Taxpayers should make consistent entity status elections (as defined in paragraph (h)(3) of this section), where applicable, in both the United States and the Virgin Islands. In the case of a business entity to which this paragraph (h) applies:

(i) If an entity status election is filed with the Internal Revenue Service but not with the Virgin Islands Bureau of Internal Revenue (BIR), the Director of the BIR or

his delegate, at his discretion, may deem the election also to have been made for Virgin Islands tax purposes.

(ii) If an entity status election is filed with the BIR but not with the Internal Revenue Service, the Commissioner, at his discretion, may deem the election also to have been made for U.S. Federal tax purposes.

(iii) If inconsistent entity status elections are filed with the BIR and the Internal Revenue Service, both the Commissioner and the Director of the BIR or his delegate may, at their individual discretion, treat the elections they each received as invalid and may deem the election filed in the other jurisdiction to have been made also for tax purposes in their own jurisdiction. (See Rev. Proc. 89–8, 1989–1 C.B. 778, for procedures for requesting the assistance of the Internal Revenue Service when a taxpayer is or may be subject to inconsistent tax treatment by the Internal Revenue Service and a U.S. possession tax agency.)

(2) *Scope*. This paragraph (h) applies to the following business entities:

(i) A business entity (as defined in §301.7701–2(a) of this chapter) that is domestic (as defined in §301.7701–5 of this chapter), or otherwise treated as domestic for purposes of the Internal Revenue Code, and that is owned in whole or in part by any person who is either a bona fide resident of the Virgin Islands or a business entity created or organized in the Virgin Islands.

(ii) A business entity that is created or organized in the Virgin Islands and that is owned in whole or in part by any U.S. person (other than a bona fide resident of the Virgin Islands).

(3) *Definition*. For purposes of this section, the term *entity status election* includes an election under §301.7701–3(c) of this chapter, an election under section 1362(a), and any other similar elections.

(4) *Default status*. Solely for the purpose of determining classification of an eligible entity under §301.7701–3(b), and §301.7701–3(b) as mirrored in the Virgin Islands, an eligible entity subject to this paragraph (h) shall be classified for both U.S. Federal and Virgin Islands tax purposes using the rule that applies to domestic eligible entities.

(5) *Transition rules*— (i) In the case of an election filed prior to April 11, 2005, except as provided in paragraph (h)(5)(ii) of this section, the rules of paragraph (h)(1) of this section shall apply as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(ii) In the unlikely circumstance that inconsistent elections described in paragraph (h)(1)(iii) are filed prior to April 11, 2005, and the entity cannot change its classification to achieve consistency because of the sixty-month limitation described in §301.7701–3(c)(1)(iv) of this chapter, then the entity may nevertheless request permission from the Commissioner or the Director of the BIR or his delegate to change such election to avoid inconsistent treatment by the Commissioner and the Director of the BIR or his delegate.

(iii) Except as provided in paragraphs (h)(5)(i) and (h)(5)(ii) of this section, in the case of an election filed with respect to an entity before it became an entity described in paragraph (h)(2) of this section, the rules of paragraph (h)(1) of this section shall apply as of the first day that such entity is described in paragraph (h)(2) of this section.

(iv) In the case of an entity created or organized prior to April 11, 2005, paragraph (h)(4) of this section shall take effect for U.S. Federal income tax purposes (or Virgin Islands income tax purposes, as the case may be) as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(i) *Examples*. The rules of this section are illustrated by the following examples:

Example 1. (i) A is a U.S. citizen who resides in State R. The Federal Individual Income Tax Return, Form 1040, that A prepares for 2004 reports adjusted gross income of $90x, including $30x from sources in the U.S. Virgin Islands (USVI). The income tax liability reported on A's Form 1040 is $18x. A files a copy of his Federal Form 1040 with the USVI Bureau of Internal Revenue as required by section 932(a)(2) and paragraph (b)(1) of this section, and pays the applicable percentage of his Federal income tax liability to the USVI as required by section 932(b) and paragraph (b)(2) of this section, computed as follows:

30/90 x 18x = $6x income tax liability to the USVI

(ii) A claims a credit against his Federal income tax liability reported on his Form 1040 in the amount of $6x. A attaches a Form 8689, "*Allocation of Individual Income Tax to the Virgin Islands*," to the Form 1040 filed with the Internal Revenue Service and to the copy of the Form 1040 filed with the USVI.

Example 2. B, a U.S. citizen, files returns on a calendar year basis. In April 2005, B moves to the U.S. Virgin Islands (USVI), purchases a house, and accepts a permanent position with a local employer. For the remainder of the year and throughout 2006, B continues to live and work in the USVI, and establishes a closer connection to the USVI than to the United States or any foreign country. In September 2007, as a result of the termination of his employment in the USVI, B sells his house and moves to State G. As a consequence of his employment in the USVI, B earns income from the performance of services in the USVI from April 2005 through September 2007. Section 932(c) and paragraph (c) of this section apply to B for 2006, but not for 2005 or 2007 (assuming that during the first quarter of 2005 and the last quarter of 2007, B has a tax home outside of the USVI or a closer connection to the United States or a foreign country). For 2005 and 2007, B is subject to the rules of sections 932(a) and (b) and paragraph (b) of this section because he has income derived from sources within the USVI as determined under the rules of section 937(b) and §1.937–2T.

Example 3. H and W are U.S. citizens. H resides in State T and W is a bona fide resident of the U.S. Virgin Islands (USVI). For 2004, H and W prepare a joint Individual Income Tax Return, Form 1040, which reports total adjusted gross income of $75x of which $40x is attributable to compensation that W received for services performed in the USVI and $35x to compensation that H received for services performed in State T. Pursuant to section 932(d) and paragraph (d) of this section, the joint income tax return of H and W is filed with the USVI as required by section 932(c) and paragraph (c) of this section. H and W may claim a tax credit on such return for income tax withheld during 2004 and paid to the Internal Revenue Service.

Example 4. (i) The facts are the same as in example 3, except that H also earns $25x for services performed in the USVI, so that H and W's total adjusted gross income is $100x, and their total income tax liability is $20x.

(ii) Pursuant to section 932(d) and paragraph (d) of this section, H and W must file a copy of their joint Federal Form 1040 with the Bureau of Internal Revenue of the USVI as required by section 932(a)(2) and paragraph (b)(1) of this section, and pay the applicable percentage of their Federal income tax liability to the USVI as required by section 932(b) and paragraph (b)(2) of this section, computed as follows:

65/100 x 20x = $13x income tax liability to the USVI

(iii) H and W claim a credit against their Federal income tax liability reported on the Form 1040 in the amount of $13x, the portion of their Federal income tax liability required to be paid to the USVI. H and W attach a Form 8689, "Allocation of Individual Income Tax to the Virgin Islands," to the Form 1040 filed with the Internal Revenue Service and to the copy of the Form 1040 filed with the USVI.

Example 5. J is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands (USVI). In 2005, J receives compensation for services performed in the USVI in the amount of $40x. J prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports gross income of only $30x. J has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes and, therefore, must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

Example 6. (i) N is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands. In 2004, N re-

ceives compensation for services performed in Country M. N prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports the compensation as income effectively connected with the conduct of a trade or business in the USVI. N claims a special credit against the tax on this compensation purportedly pursuant to a USVI law enacted within the limits of its authority under section 934.

(ii) Under the principles of section 864(c)(4) as applied pursuant to section 937(b)(1) and §1.937–3T(b), compensation for services performed outside the USVI may not be treated as income effectively connected with the conduct of a trade or business in the USVI for purposes of section 934(b). Consequently, N is not entitled to claim the special credit under USVI law with respect to N's income from services performed in Country M. Given that N has not fully paid his tax liability referred to in section 934(a), he has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes. Accordingly, N must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

(j) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 23. Section 1.933–1 is amended by revising paragraphs (a) and (c) and adding paragraphs (d) and (e) to read as follows:

§1.933–1 Exclusion of certain income from sources within Puerto Rico.

(a) [Reserved]. For further guidance, see §1.933–1T(a).

* * * * *

(c) [Reserved]. For further guidance, see §1.933–1T(c).

(d) [Reserved]. For further guidance, see §1.933–1T(d).

(e) [Reserved]. For further guidance, see §1.933–1T(e).

Par. 24. Section 1.933–1T is added to read as follows:

§1.933–1T Exclusion of certain income from sources within Puerto Rico (temporary).

(a) *General rule*— (1) An individual (whether a United States citizen or an alien), who is a bona fide resident of Puerto Rico during the entire taxable year, shall exclude from gross income the income derived from sources within Puerto Rico, except amounts received for services performed as an employee of the United States or any agency thereof.

(2) The following example illustrates the application of the general rule in paragraph (a)(1) of this section:

Example. E, a United States citizen, files returns on a calendar year basis. In April 2005, E moves to Puerto Rico, purchases a house, and accepts a permanent position with a local employer. For the remainder of the year and throughout 2006, E continues to live and work in Puerto Rico, and establishes a closer connection to Puerto Rico than to the United States or any foreign country. In September 2007, as a result of the termination of his employment in Puerto Rico, E sells his house and moves to State J. E is entitled to the exclusion provided in section 933 for 2006, but not for 2005 or 2007 (assuming that during the first quarter of 2005 and the last quarter of 2007, E has a tax home outside of Puerto Rico or a closer connection to the United States or a foreign country).

(b) [Reserved]. For further guidance, see §1.933–1(b).

(c) *Deductions and credits*. In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 933, there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions (except the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to, or chargeable against, the amounts so excluded from gross income. For purposes of the preceding sentence, the rules of §1.861–8 shall apply (with creditable expenditures treated in the same manner as deductible expenditures).

(d) *Definitions*. For purposes of this section:

(1) The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of Puerto Rico.

(2) The rules of §1.937–2T shall apply for determining whether income is from sources within Puerto Rico.

(e) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 25. Section 1.934–1 is revised to read as follows:

§1.934–1 Limitation on reduction in income tax liability incurred to the Virgin Islands.

[Reserved]. For further guidance, see §1.934–1T.

Par. 26. Section 1.934–1T is added to read as follows:

§1.934–1T Limitation on reduction in income tax liability incurred to the Virgin Islands (temporary).

(a) *General rule*. Section 934(a) provides that tax liability incurred to the United States Virgin Islands (Virgin Islands) 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 section 934(b). For purposes of the preceding sentence, the term "tax liability" means the liability incurred to the Virgin Islands pursuant to subtitle A of the Internal Revenue Code, as made applicable in the Virgin Islands by the Act of July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642), as modified by section 7651(5)(B).

(b) *Exception for V.I. income*— (1) *In general*. Section 934(b)(1) provides an exception to the application of section 934(a). Under this exception, section 934(a) does not apply with respect to tax liability incurred to the Virgin Islands to the extent that such tax liability 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) *Limitation*. Section 934(b)(2) limits the scope of the exception provided by section 934(b)(1). Pursuant to this limitation, the exception does not apply with respect to an individual who is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands). For the rules for determining tax liability incurred to the Virgin Islands by such an individual, see section 932(a) and the regulations thereunder.

(3) *Computation rule*— (i) *Operative rule*. For purposes of section 934(b)(1) and this paragraph (b), tax liability incurred to the Virgin Islands for the taxable year 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 shall be computed as follows:

(A) Add to the income tax liability incurred to the Virgin Islands any credit against the tax allowed under mirrored section 901(a);

(B) Multiply by taxable income from sources within the Virgin Islands and income effectively connected with the conduct of a trade or business within the Virgin Islands (applying the rules of §1.861–8 to determine deductions allocable to such income);

(C) Divide by total taxable income; and

(D) Subtract the portion of any credit allowed under mirrored section 901 (other than credits for taxes paid to the United States) determined by multiplying the amount of taxable income from sources outside the Virgin Islands or the United States that is effectively connected to the conduct of a trade or business in the Virgin Islands divided by the total amount of taxable income from such sources.

(ii) *Limitation*. Tax liability incurred to the Virgin Islands 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, as computed in this paragraph (b)(3), however, shall not exceed the total amount of income tax liability actually incurred.

(4) *Definitions*. For purposes of this section:

(i) *Bona fide resident*. The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of the Virgin Islands.

(ii) *Source*. The rules of §1.937–2T shall apply for determining whether income is from sources within the Virgin Islands.

(iii) *Effectively connected income*. The rules of §1.937–3T shall apply for determining whether income is effectively connected with the conduct of a trade or business in the Virgin Islands.

(c) *Exception for qualified foreign corporations*— (1) *In general*. Section 934(b)(3) provides an exception to the application of section 934(a). Under this exception, section 934(a) does not apply with respect to tax liability incurred to the Virgin Islands by a qualified foreign corporation to the extent that such tax liability 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.

(2) *Qualified foreign corporation*. For purposes of paragraph (c)(1) of this section, the term *qualified foreign corporation* means any foreign corporation if 1 or more United States persons own or are treated as owning (within the meaning of section 958) 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,

(3) *Computation rule*— (i) *Operative rule*. For purposes of section 934(b)(3) and this paragraph (c), tax liability incurred to the Virgin Islands for the taxable year 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 shall be computed as follows—

(A) Add to the income tax liability incurred to the Virgin Islands any credit against the tax allowed under mirrored section 901(a);

(B) Multiply by taxable 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 (applying the rules of §1.861–8 to determine deductions allocable to such income);

(C) Divide by total taxable income; and

(D) Subtract any credit allowed under mirrored section 901 (other than credits for taxes paid to the United States or taxes for which a credit is allowable for U.S. Federal income tax purposes under section 906 of the Internal Revenue Code).

(ii) *Limitation*. Tax liability incurred to the Virgin Islands 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, as computed in this paragraph (c)(3), however, shall not exceed the total amount of income tax liability actually incurred.

(4) *U.S. income*— (i) *In general*. For purposes of this section, except as provided in paragraph (c)(4)(ii) of this section, the rules of sections 861 through 865 and the regulations thereunder shall apply for determining whether income is from sources outside the United States or effectively connected with the conduct of a trade or business within the United States.

(ii) *Conduit arrangements*. Income shall be considered to be from sources within the United States for purposes of paragraph (c)(1) of this section if, pursuant to a plan or arrangement—

(A) The income is received in exchange for consideration provided to another person; and

(B) Such person (or another person) provides the same consideration (or consideration of a like kind) to a third person in exchange for one or more payments constituting income from sources within the United States.

(d) *Examples*. The rules of this section are illustrated by the following examples:

Example 1. (i) S is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands (USVI). For 2005, S files a Form 1040INFO, "*Non-Virgin Islands Source Income of Virgin Islands Residents*," with the USVI on which S reports total gross income as follows:

Compensation for services performed in the USVI	$50,000
Compensation for services performed in the United States	40,000
Compensation for services performed in Mexico	30,000
Income from inventory sales in Latin America attributable to USVI Office	20,000
Interest on a U.S. bank account	6,000
Interest on a V.I. bank account	5,000
Dividends from a U.S. corporation	4,000

(ii) Accordingly, S has total gross income of $155,000, comprising income from sources within the USVI or effectively connected to the conduct of a trade or business in the USVI (USVI ECI) of $75,000, income from sources within the United States of $50,000, and income from other sources (not USVI ECI) of $30,000. After taking into account allowable deductions, S's total taxable income is $120,000, of which $45,000 is taxable income from

sources within the USVI, $15,000 is taxable income from other sources that is USVI ECI under the rules of section 937(b) and §§1.937–2T and 1.937–3T, and $22,500 is taxable income from sources outside the USVI (and outside the United States) that is not USVI ECI. S's tax liability incurred to the USVI pursuant to the Internal Revenue Code as applicable in the USVI (mirror code) is $30,000. S is entitled to claim a credit under section 901 of the mirror code in the amount of $10,000 for income tax paid to Mexico and other Latin American countries, for a net income tax liability of $20,000.

(iii) Pursuant to a USVI law that was duly enacted within the limits of its authority under section 934, S may claim a special deduction relating to his business activities in the USVI. However, under section 934(b), S's ability to claim this special deduction is limited. Specifically, the maximum amount of the reduction in S's mirror code tax liability that may result from claiming this deduction, computed in accordance with paragraph (b)(3) of this section, is as follows:

(20,000 + 10,000) x ((45,000 + 15,000) / (120,000)) - 10,000 x ((15,000) / (15,000 + 22,500))
= 30,000 x (.5) - 10,000 x (.4) = 15,000 - 4,000 = $11,000

(iv) Accordingly, S's net tax liability incurred to the USVI must be at least $19,000 (30,000 - 11,000), prior to taking into account any foreign tax credit.

Example 2. The facts are the same as *Example 1*, except that S is a U.S. citizen who resides in the United States. As required by section 932(a) and (b), S files with the U.S. Virgin Islands (USVI) a copy of his Federal income tax return and pays to the USVI the portion of his Federal income tax liability that his Virgin Islands adjusted gross income bears to his adjusted gross income. Under section 934(b)(2), S may not claim the special deduction offered under USVI law relating to business activities like his in the USVI to reduce any of his tax liability payable to the USVI under section 932(b).

Example 3. (i) Z is a nonresident alien who resides in Country FC. In 2005, Z receives dividends from a corporation organized under the law of the U.S. Virgin Islands (USVI) in the amount of $90x. Z's tax liability incurred to the USVI pursuant to section 871(a) of the Internal Revenue Code as applicable in the USVI (mirror code) is $27x.

(ii) Pursuant to a USVI law that was duly enacted within the limits of its authority under section 934, Z may claim a special exemption for income relating to his investment in the USVI. The maximum amount of the reduction in Z's mirror code tax liability that may result from claiming this exemption, computed in accordance with paragraph (b)(3) of this section, is as follows:

27x (90x/90x) = $27x

(iii) Accordingly, depending on the terms of the exemption as provided under USVI law, Z's net tax liability incurred to the USVI may be reduced or eliminated entirely.

Example 4. (i) A Corp is organized under the laws of the U.S. Virgin Islands (USVI) and is engaged in a trade or business in the United States through an office in State N. All of A Corp's outstanding stock is owned by U.S. citizens who are bona fide residents of the USVI. During 2005, A Corp had $50x in gross income from sources within the USVI (as determined under section 937(b) and §1.937–2T) that is not effectively connected with the conduct of a trade or business in the United States; $20x in gross income from sources in Country H that is effectively connected with the conduct of A Corp's trade or business in the United States; and $10x in gross income from sources in Country R that is not effectively connected with the conduct of A Corp's trade or business in the United States.

(ii) Section 934(b)(3) permits the USVI to reduce or remit the income tax liability of a *qualified foreign corporation* arising under the Internal Revenue Code as applicable in the USVI (mirror code) with respect to income that is derived from sources outside the United States and that is not effectively connected with the conduct of a trade or business in the United States. A foreign corporation constitutes a "qualified foreign corporation" under section 934(b)(3)(B) if less than 10 percent of the total voting power and value of the stock of the corporation is owned or treated as owned (within the meaning of section 958) by one or more United States persons. A U.S. citizen is a *United States person* as defined in section 7701(a)(30)(A). Given that 10 percent or more of the voting power and value of its stock is owned by U.S. citizens, A Corp does not constitute a "qualified foreign corporation" under section 934(b)(3)(B). Accordingly, the USVI may only reduce or remit A Corp's mirror code income tax liability with respect to its $50x in gross income from sources within the USVI.

Example 5. (i) The facts are the same as in *Example 4*, except that the outstanding stock of A Corp is owned by the following individuals:

U. S. citizens who are bona fide residents of the USVI	5%
U. S. citizens who are not bona fide residents of the USVI	3%
Nonresident aliens who are bona fide residents of the USVI	42%
Nonresident aliens who are not bona fide residents of the USVI	50%

(ii) Given that less than 10 percent of the voting power and value of its stock is owned by United States persons, A Corp constitutes a *qualified foreign corporation* under section 934(b)(3)(B). Accordingly, the USVI may reduce or remit A Corp's mirror code income tax liability with respect to its $50x in gross income from sources within the USVI and its $10x in gross income from sources in Country R that is not effectively connected with the conduct of A Corp's trade or business in the United States. In no event, however, may the USVI reduce or remit A Corp's mirror code income tax liability with respect to its $20x in gross income from sources in Country H that is effectively connected with the conduct of A Corp's trade or business in the United States.

(e) *Effective date*. Except as otherwise provided in this paragraph (e), this section applies for taxable years ending after October 22, 2004. Paragraph (c)(4)(ii) of this section applies to amounts paid or accrued after April 11, 2005.

Par. 27. Section 1.935–1 is amended as follows:

1. Revise the heading and paragraphs (a)(1) through (a)(3).

2. Revise paragraphs (b)(1) and (b)(3), and add paragraphs (b)(5) through (b)(7).

3. Revise paragraphs (c) through (f).

4. Add paragraph (g).

The revisions and additions are as follows:

§1.935–1 Coordination of individual income taxes with Guam and the Northern Mariana Islands.

(a)(1) through (a)(3) [Reserved]. For further guidance, see §1.935–1T(a)(1) through (a)(3).

(b)(1) [Reserved]. For further guidance, see §1.935–1T(b)(1).

* * * * *

(b)(3) [Reserved]. For further guidance, see §1.935–1T(b)(3).

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(b)(5) through (b)(7) [Reserved]. For further guidance, see §1.935–1T(b)(5) through (b)(7).

(c) through (f) [Reserved]. For further guidance, see §1.935–1T(c) through (f).

(g) [Reserved]. For further guidance, see §1.935–1T(g).

Par. 28. Section 1.935–1T is added to read as follows:

§1.935–1T Coordination of individual income taxes with Guam and the Northern Mariana Islands (temporary).

(a) *Application of section*— (1) *Scope*. Section 935 and this section set forth the special rules relating to the filing of income tax returns, income tax liabilities, and estimated income tax of individuals described in paragraph (a)(2) of this section. Paragraph (e) of this section also provides special rules requiring consistent treatment of business entities in the United States and in section 935 possessions.

(2) *Individuals covered*. This section shall apply to any individual who—

(i) Is a bona fide resident of a section 935 possession during the entire taxable year, whether or not such individual is a citizen of the United States or a resident alien (as defined in section 7701(b)(1)(A));

(ii) Is a citizen of a section 935 possession but not otherwise a citizen of the United States;

(iii) Has income from sources within a section 935 possession for the taxable year, is a citizen of the United States or a resident alien (as defined in section 7701(b)(1)(A)) and is not a bona fide resident of a section 935 possession during the entire taxable year; or

(iv) Files a joint return for the taxable year with any individual described in paragraph (a)(2)(i), (ii), or (iii) of this section.

(3) *Definitions*. For purposes of this section:

(i) The term *section 935 possession* means Guam or the Northern Mariana Islands, unless such possession has entered into an implementing agreement, as described in section 1271(b) of the Tax Reform Act of 1986 (Public Law 99–514 (100 Stat. 2085)), with the United States that is in effect for the entire taxable year.

(ii) The term *relevant possession* means:

(A) With respect to an individual described in paragraph (a)(2)(i) of this section, the section 935 possession of which such individual is a bona fide resident.

(B) With respect to an individual described in paragraph (a)(2)(ii) of this section, the section 935 possession of which such individual is a citizen.

(C) With respect to an individual described in paragraph (a)(2)(iii) of this section, the section 935 possession from which such individual derives income.

(iii) The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of a section 935 possession.

(iv) The rules of §1.937–2T generally shall apply for determining whether income is from sources within a section 935 possession. Pursuant to §1.937–2T(a), however, the rules of §1.937–2T(c)(1)(ii) and (c)(2) do not apply for purposes of section 935(a)(3) (as in effect before the effective date of its repeal) and paragraph (a)(2)(iii) of this section.

(v) The term *citizen of the United States* means any individual who is a citizen within the meaning of §1.1–1(c), except that the term does not include an individual who is a citizen of a section 935 possession but not otherwise a citizen of the United States. The term *citizen of a section 935 possession but not otherwise a citizen of the United States* means any individual who has become a citizen of the United States by birth or naturalization in the section 935 possession.

(vi) With respect to the United States, the term *resident* means an individual who is a citizen (as defined in §1.1–1(c)) or resident alien (as defined in section 7701(b)) and who does not have a tax home (as defined in section 911(d)(3)) in a foreign country during the entire taxable year. The term does not include an individual who is a bona fide resident of a section 935 possession.

(vii) The term *U.S. taxpayer* means an individual described in paragraph (b)(1)(i) or (iii)(B) of this section.

(b) *Filing requirement*— (1) *Tax jurisdiction*. An individual described in paragraph (a)(2) of this section shall file an income tax return for the taxable year—

(i) With the United States if such individual is a resident of the United States;

(ii) With the relevant possession if such individual is described in paragraph (a)(2)(i) of this section; or

(iii) If neither paragraph (b)(1)(i) nor paragraph (b)(1)(ii) of this section applies—

(A) With the relevant possession if such individual is described in paragraph (a)(2)(ii) of this section; or

(B) With the United States if such individual is a citizen of the United States, as defined in paragraph (a)(3) of this section.

(2) [Reserved]. For further guidance, see §1.935–1(b)(2).

(3) *Place for filing returns*— (i) *U.S. returns*. A return required under this paragraph (b) to be filed with the United States shall be filed as directed in the applicable forms and instructions.

(ii) *Guam returns*. A return required under this paragraph (b) to be filed with Guam shall be filed as directed in the applicable forms and instructions.

(iii) *NMI returns*. A return required under this paragraph (b) to be filed with the Northern Mariana Islands shall be filed as directed in the applicable forms and instructions

(4) [Reserved]. For further guidance, see §1.935–1(b)(4).

(5) *Tax payments*. The tax shown on the return shall be paid to the jurisdiction with which such return is required to be filed and shall be determined by taking into account any credit under section 31 for tax withheld by the relevant possession or the United States on wages, any credit under section 6402(b) for an overpayment of income tax to the relevant possession or the United States, and any payments under section 6315 of estimated income tax paid to the relevant possession or the United States.

(6) *Liability to other jurisdiction*— (i) *Filing with the relevant possession*. In the case of an individual who is required under paragraph (b)(1) of this section to file a return with the relevant possession for a taxable year, if such individual properly files such return and fully pays his or her income tax liability to the relevant possession, such individual is relieved of liability to file an income tax return with, and to pay an income tax to, the United States for the taxable year.

(ii) *Filing with the United States*. In the case of an individual who is required under paragraph (b)(1) of this section to file a return with the United States for a taxable year, such individual is relieved of liability to file an income tax return with, and to pay an income tax to, the relevant possession for the taxable year.

(7) *Information reporting*. [Reserved].

(c) *Extension of territory*— (1) *U.S. taxpayers*— (i) *General rule*. With respect to a U.S. taxpayer, for purposes of taxes imposed by Chapter 1 of the Internal Revenue Code, the United States generally shall be treated, in a geographical and governmental sense, as including the relevant possession. The purpose of this rule is to facilitate the coordination of the tax systems of the United States and the relevant possession. Accordingly, the rule will have no effect where it is manifestly inapplicable or its application would be incompatible with the intent of any provision of the Internal Revenue Code.

(ii) *Application of general rule*. Contexts in which the general rule of paragraph (c)(1)(i) of this section apply include:

(A) The characterization of taxes paid to the relevant possession. Income tax paid to the relevant possession may be taken into account under sections 31, 6315, and 6402(b) as payments to the United States. Taxes paid to the relevant possession and otherwise satisfying the requirements of section 164(a) will be allowed as a deduction under that section, but income taxes paid to the relevant possession will be disallowed as a deduction under section 275(a).

(B) The determination of the source of income for purposes of the foreign tax credit (*e.g.*, sections 901 through 904). Thus, for example, after a U.S. taxpayer determines which items of income constitute income from sources within the relevant possession under the rules of section 937(b), such income shall be treated as income from sources within the United States for purposes of section 904.

(C) The eligibility of a corporation to make a subchapter S election (sections 1361 through 1379). Thus, for example, for purposes of determining whether a corporation created or organized in the relevant possession may make an election under section 1362(a) to be a subchapter S corporation, it shall be treated as a domestic corporation and a U.S. taxpayer shareholder shall not be treated as a nonresident alien individual with respect to such corporation. While such an election is in effect, the corporation shall be treated as a domestic corporation for all purposes of the Internal Revenue Code. For the consistency requirement with respect to entity status elections, see paragraph (e) of this section.

(D) The treatment of items carried over from other tax years. Thus, for example, if a U.S. taxpayer has for a taxable year a net operating loss carryback or carryover under section 172, a foreign tax credit carryback or carryover under section 904, a business credit carryback or carryover under section 39, a capital loss carryover under section 1212, or a charitable contributions carryover under section 170, the carryback or carryover will be reported on the return filed with the United States in accordance with paragraph (b)(1)(i) or (b)(1)(iii)(B) of this section, even though the return of the taxpayer for the taxable year giving rise to the carryback or carryover was required to be filed with a section 935 possession.

(E) The treatment of property exchanged for property of a like kind (section 1031). Thus for example, if a U.S. taxpayer exchanges real property located in the United States for real property located in the relevant possession, notwithstanding the provisions of section 1031(h), such exchange may qualify as a like-kind exchange under section 1031 (provided that all the other requirements of section 1031 are satisfied).

(iii) *Nonapplication of general rule*. Contexts in which the general rule of paragraph (c)(1)(i) of this section does not apply include:

(A) The application of any rules or regulations that explicitly treat the United States and any (or all) of its possessions as separate jurisdictions (*e.g.*, sections 931 through 937, 7651, and 7654).

(B) The determination of any aspect of an individual's residency (*e.g.*, sections 937(a) and 7701(b)). Thus, for example, an individual whose principal place of abode is in the relevant possession is not considered to have a principal place of abode in the United States for purposes of section 32(c).

(C) The determination of the source of income for purposes other than the foreign tax credit (*e.g.*, sections 935, 937, and 7654). Thus, for example, income determined to be derived from sources within the relevant possession under section 937(b) shall not be considered income from sources within the United States for purposes of Form 5074, "*Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands*".

(D) The definition of wages (section 3401). Thus, for example, services performed by an employee for an employer in the relevant possession do not constitute services performed in the United States under section 3401(a)(8).

(E) The characterization of a corporation for purposes other than subchapter S (*e.g.*, sections 367, 951 through 964, 1291 through 1298, 6038, and 6038B). Thus, for example, if a U.S. taxpayer transfers appreciated tangible property to a corporation created or organized in the relevant possession in a transaction described in section 351, he or she must recognize gain unless an exception under section 367(a) applies. Also, if a corporation created or organized in the relevant possession qualifies as a passive foreign investment company under sections 1297 and 1298 with respect to a U.S. taxpayer, a dividend paid to such shareholder does not constitute qualified dividend income under section 1(h)(11)(B).

(2) *Application in relevant possession*. In applying the territorial income tax of the relevant possession, such possession generally shall be treated, in a geographical and governmental sense, as including the United States. Thus, for example, income tax paid to the United States may be taken into account under sections 31, 6315, and 6402(b) as payments to the relevant possession. Moreover, a citizen of the United States (as defined in paragraph (a)(3) of this section) not a resident of the relevant possession will not be treated as a nonresident alien individual for purposes of the territorial income tax of the relevant possession. Thus, for example, a citizen of the United States (as so defined), or a resident of the United States, will not be treated as a nonresident alien individual for purposes of section 1361(b)(1)(C) of the Guamanian Territorial income tax.

(d) *Special rules for estimated income tax*— (1) *In general*. An individual must make each payment of estimated income tax (and any amendment to the estimated tax payment) to the jurisdiction with which the individual reasonably believes, as of the date of that payment (or amendment), that he or she will be required to file a return for the taxable year under paragraph (b)(1) of this section. In determining the amount of such estimated income tax, income tax paid to the relevant possession may be taken into account under sections

31 and 6402(b) as payments to the United States, and vice versa. For other rules relating to estimated income tax, see section 6654.

(2) *Joint estimated income tax*. In the case of married persons making a joint payment of estimated income tax, the taxpayers must make each payment of estimated income tax (and any amendment to the estimated tax payment) to the jurisdiction where the spouse who has the greater estimated adjusted gross income for the taxable year would be required under paragraph (d)(1) of this section to pay estimated income tax if separate payments were made. For this purpose, estimated adjusted gross income of each spouse for the taxable year is determined without regard to community property laws.

(3) *Erroneous payment*. If the individual or spouses erroneously pay estimated income tax to the United States instead of the relevant possession or vice versa, only subsequent payments or amendments of the payments are required to be made pursuant to paragraph (d)(1) or (d)(2) of this section with the other jurisdiction.

(4) *Place for payment*. Estimated income tax required under this paragraph (d) to be paid to Guam or the Northern Mariana Islands shall be paid as directed in the applicable forms and instructions issued by the relevant possession. Estimated income tax required under paragraph (d)(1) of this section to be paid to the United States shall be paid as directed in the applicable forms and instructions.

(5) *Liability to other jurisdiction*— (i) *Filing with Guam or the Northern Mariana Islands*. Subject to paragraph (d)(6) of this section, an individual required under this paragraph (d) to pay estimated income tax (and amendments thereof) to Guam or the Northern Mariana Islands is relieved of liability to pay estimated income tax (and amendments thereof) to the United States.

(ii) *Filing with the United States*. Subject to paragraph (d)(6) of this section, an individual required under this paragraph (d) to pay estimated income tax (and amendments thereof) to the United States is relieved of liability to pay estimated income tax (and amendments thereof) to the relevant possession.

(6) *Underpayments*. The liability of an individual described in paragraph (a)(2) of this section for underpayments of estimated income tax for a taxable year, as determined under section 6654, shall be to the jurisdiction with which the individual is required under paragraph (b) of this section to file his or her return for the taxable year.

(e) *Entity status consistency requirement*— (1) *In general*. Taxpayers should make consistent entity status elections (as defined in paragraph (e)(3)(ii) of this section), when applicable, in both the United States and section 935 possessions. In the case of a business entity to which this paragraph (e) applies:

(i) If an entity status election is filed with the Internal Revenue Service but not with the relevant possession, the appropriate tax authority of the relevant possession, at his discretion, may deem the election also to have been made for the relevant possession tax purposes.

(ii) If an entity status election is filed with the relevant possession but not with the Internal Revenue Service, the Commissioner, at his discretion, may deem the election also to have been made for U.S. Federal tax purposes.

(iii) If inconsistent entity status elections are filed with the relevant possession and the Internal Revenue Service, both the Commissioner and the appropriate tax authority of the relevant possession may, at their individual discretion, treat the elections they each received as invalid and may deem the election filed in the other jurisdiction to have been made also for tax purposes in their own jurisdiction. (See Rev. Proc. 89–8, 1989–1 C.B. 778, for procedures for requesting the assistance of the Internal Revenue Service when a taxpayer is or may be subject to inconsistent tax treatment by the Internal Revenue Service and a U.S. possession tax agency.)

(2) *Scope*. This paragraph (e) applies to the following business entities:

(i) A business entity (as defined in §301.7701–2(a) of this chapter) that is domestic (as defined in §301.7701–5 of this chapter), or otherwise treated as domestic for purposes of the Internal Revenue Code, and that is owned in whole or in part by any person who is either a bona fide resident of a section 935 possession or a business entity created or organized in a section 935 possession.

(ii) A business entity that is created or organized in a section 935 possession and that is owned in whole or in part by any U.S. person (other than a bona fide resident of such possession).

(3) *Definitions*. For purposes of this section—

(i) The term *appropriate tax authority of the relevant possession* means the individual responsible for tax administration in such possession or his delegate.

(ii) The term *entity status election* includes an election under §301.7701–3(c) of this chapter, an election under section 1362(a), and any other similar elections.

(4) *Default status*. Solely for the purpose of determining classification of an eligible entity under §301.7701–3(b), and §301.7701–3(b) as mirrored in the relevant possession, an eligible entity subject to this paragraph (e) shall be classified for both U.S. Federal and the relevant possession tax purposes using the rule that applies to domestic eligible entities.

(5) *Transition rules*— (i) In the case of an election filed prior to April 11, 2005, except as provided in paragraph (e)(5)(ii) of this section, the rules of paragraph (e)(1) of this section shall apply as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(ii) In the unlikely circumstance that inconsistent elections described in paragraph (e)(1)(iii) are filed prior to April 11, 2005, and the entity cannot change its classification to achieve consistency because of the sixty-month limitation described in §301.7701–3(c)(1)(iv) of this chapter, then the entity may nevertheless request permission from the Commissioner or appropriate tax authority of the relevant possession to change such election to avoid inconsistent treatment by the Commissioner and the appropriate tax authority of the relevant possession.

(iii) Except as provided in paragraphs (e)(5)(i) and (e)(5)(ii) of this section, in the case of an election filed with respect to an entity before it became an entity described in paragraph (e)(2) of this section, the rules of paragraph (e)(1) of this section shall apply as of the first day that such entity is described in paragraph (e)(2) of this section.

(iv) In the case of an entity created or organized prior to April 11, 2005, paragraph (e)(4) of this section shall take effect for U.S. Federal income tax purposes (or the relevant possession income tax purposes, as the case may be) as of the first day of the first taxable year of the entity beginning after April 11, 2005.

(f) *Examples*. The application of this section is illustrated by the following examples:

Example 1. B, a United States citizen, files returns on a calendar year basis. In April 2005, B moves to Possession G, which is a section 935 possession, purchases a house, and accepts a permanent position with a local employer. For the remainder of the year and throughout 2006, B continues to live and work in Possession G, and establishes a closer connection to Possession G than to the United States or any foreign country. In September 2007, as a result of the termination of his employment in Possession G, B sells his house and moves to State H. As a consequence of his employment in Possession G, B earns income from the performance of services in Possession G from April 2005 through September 2007. Section 935(b)(1)(B) and paragraph (b)(1)(ii) of this section apply to B for 2006, but not for 2005 or 2007 (assuming that during the first quarter of 2005 and the last quarter of 2007, B has a tax home outside of Possession G or a closer connection to the United States or a foreign country). For 2005 and 2007, B is subject to the rules applicable to individuals described in paragraph (a)(2)(iii) of this section because he has income derived from sources within Possession G as determined under the rules of section 937(b) and §1.937–2T.

Example 2. The facts are the same as in *Example 1* except that B's employment terminated in September 2008 rather than 2007. B properly pays his April 2005 estimated tax to the United States, continues to pay estimated tax for the 2005 tax year to the United States under paragraph (d) of this section, and properly files his 2005 return with the United States.

(i)(A) On the date of each payment of estimated tax in 2006, B reasonably believes that he would be required to file his return for 2006 with Possession G under paragraph (b)(1) of this section.

(B) In August 2006, B determines that he has overpaid tax for the previous year in the amount of $1000. B properly pays all estimated taxes to Possession G for 2006, subtracting the $1000 overpayment from his estimated tax payments pursuant to section 6402(b), and properly files his tax return with Possession G.

(ii) In April 2007, B reasonably believes that he would be returning to the United States in the Fall of 2007, and properly pays estimated tax to the United States. By June 2007, B reasonably believes that he would not be moving from Possession G and would be a bona fide resident of Possession G for the entire taxable year. B makes his remaining estimated tax payments to Possession G. On his 2007 tax return filed with Possession G, pursuant to section 6315, B properly takes into account payments made to both the United States and Possession G as estimated taxes.

(iii) In April and June 2008, B reasonably believes that he would be a bona fide resident of Possession G for the entire taxable year 2008 and properly pays estimated taxes to Possession G. By the time B pays his estimated taxes for September 2008, B's employment terminates and he moves to State H. B properly makes his remaining estimated tax payments to the United States. On his return for 2008, properly filed with the United States, B determines that he has underpaid estimated taxes throughout 2008 in an amount subject to penalty under section 6654. B owes the United States an estimated tax penalty under section 6654.

(g) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 29. Section 1.937–1T is added to read as follows:

§1.937–1T Bona fide residency in a possession (temporary).

(a) *Scope*— (1) *In general*. Section 937(a) and this section set forth the rules for determining whether an individual qualifies as a bona fide resident of a particular possession (the relevant possession) for purposes of the Internal Revenue Code, including Subpart D, Part III, Subchapter N, Chapter 1 of the Internal Revenue Code as well as 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).

(2) *Definitions*. For purposes of this section and §§1.937–2 and 1.937–3—

(i) *Possession* means one of the following United States possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands. When used in a geographical sense, the term comprises only the territory of each such possession (without application of sections 932(c)(3) and 935(c)(2) (as in effect before the effective date of its repeal)).

(ii) *United States*, when used in a geographical sense, is defined in section 7701(a)(9), and without application of sections 932(a)(3) and 935(c)(1) (as in effect before the effective date of its repeal).

(b) *Bona fide resident*— (1) *General rule*. An individual qualifies as a bona fide resident of the relevant possession if such individual satisfies the requirements of paragraphs (c) through (e) of this section with respect to such possession.

(2) *Special rule for members of the Armed Forces*. A member of the Armed Forces of the United States who qualified as a bona fide resident of the relevant possession in a prior taxable year shall be deemed to have satisfied the requirements of paragraphs (c) through (e) of this section for a subsequent taxable year if such individual otherwise is unable to satisfy such requirements by reason of being absent from such possession or present in the United States during such year solely in compliance with military orders. Conversely, a member of the Armed Forces of the United States who did not qualify as a bona fide resident of the relevant possession in a prior taxable year shall not be considered to have satisfied the requirements of paragraphs (c) through (e) of this section for a subsequent taxable year by reason of being present in such possession solely in compliance with military orders. *Armed Forces of the United States* is defined (and members of the Armed Forces are described) in section 7701(a)(15).

(3) *Juridical persons*. Only natural persons may qualify as bona fide residents of a possession. The rules governing the tax treatment of bona fide residents of a possession do not apply to juridical persons (*e.g.*, corporations, partnerships, trusts, and estates).

(4) *Transition rule*. For taxable years beginning before October 23, 2004, and ending after October 22, 2004, an individual will be considered to qualify as a bona fide resident of the relevant possession if such individual satisfies the requirements of paragraphs (d) and (e) of this section with respect to such possession for such year.

(c) *Presence test*— (1) *In general*. A United States citizen or resident alien (as defined in section 7701(b)(1)(A)) individual satisfies the requirements of this paragraph (c) for a taxable year if during that taxable year such individual—

(i) Was present in the relevant possession for at least 183 days;

(ii) Was present in the United States for no more than 90 days;

(iii) Had no earned income (as defined in §1.911–3(b)) in the United States and was present for more days in the relevant possession than in the United States; or

(iv) Had no permanent connection (see paragraph (c)(4) of this section) to the United States.

(2) *Special rule for alien individuals*. A nonresident alien individual (as defined in section 7701(b)(1)(B)) satisfies the requirements of this paragraph (c) for a taxable year if during that taxable year such individual satisfies the substantial presence test of §301.7701(b)–1(c) of this chapter (except for the substitution of the name of the relevant possession for the term *United States* where appropriate).

(3) *Days of presence*. For purposes of paragraph (c)(1) of this section—

(i) An individual is considered to be present in the relevant possession on any day that he or she is physically present in such possession at any time during the day.

(ii) An individual is considered to be present in the United States on any day that he or she is physically present in the United States at any time during the day. However, the following days shall be excluded and will not count as days of presence in the United States:

(A) Any day that an individual is prevented from leaving the United States because of a medical condition that arose while the individual was present in the United States (as described in §301.7701(b)–3(c) of this chapter);

(B) Any day that an individual is in transit between two points outside the United States (as described in §301.7701(b)–3(d) of this chapter), and is physically present in the United States for fewer than 24 hours;

(C) Any day that an individual is temporarily present in the United States as a professional athlete to compete in a charitable sports event (as described in §301.7701(b)–3(b)(5) of this chapter);

(D) Any day during which the individual is temporarily in the United States as a student (as defined in section 152(f)(2)); and

(E) In the case of an individual who is an elected representative of the relevant possession, or who serves full time as an elected or appointed official or employee of the government of the relevant possession (or any political subdivision thereof), any day spent serving the relevant possession in such role.

(iii) If, during a single day, an individual is physically present—

(A) In the United States and in the relevant possession, such day shall be considered a day of presence in the relevant possession;

(B) In two possessions, such day shall be considered a day of presence in the possession where the individual's tax home is located (applying the rules of paragraph (d) of this section).

(4) *Permanent connection*. For purposes of paragraph (c)(1) of this section—

(i) A permanent connection to the United States includes—

(A) A permanent home (as described in §301.7701(b)–2(d)(2) of this chapter) in the United States;

(B) A spouse or dependent (as defined in section 152 and the regulations thereunder) whose principal place of abode is in the United States; or

(C) Current registration to vote in any political subdivision of the United States.

(ii) However, a permanent connection to the United States does not include—

(A) A valid professional license conferred by any political subdivision of the United States; or

(B) Relatives (other than those specified in paragraph (c)(4)(i)(B) of this section) whose principal place of abode is in the United States.

(d) *Tax home test*— (1) *General rule*. An individual satisfies the requirements of this paragraph (d) for a taxable year if such individual did not have a tax home outside the relevant possession during any part of the taxable year. For purposes of section 937 and this section, an individual's tax home is determined under the principles of section 911(d)(3) without regard to the second sentence thereof. Thus, under section 937, an individual's tax home is considered to be located at the individual's regular or principal (if more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of the business, or because the individual is not engaged in carrying on any trade or business within the meaning of section 162(a), then the individual's tax home is the individual's regular place of abode in a real and substantial sense.

(2) *Special rule for seafarers*. For purposes of section 937 and this section, an individual will not be considered to have a tax home outside the relevant possession solely by reason of employment on a ship or other seafaring vessel that is predominantly used in local and international waters. For this purpose, a vessel will be considered to be predominantly used in local and international waters if, during the taxable year, the aggregate amount of time it is used in international water and in the water within three miles of the relevant possession exceeds the aggregate amount of time it is used in the territorial water of the United States or any foreign country.

(3) *Special rule for students and government officials*. Any days described in paragraphs (c)(3)(ii)(D) and (E) of this section shall be disregarded for purposes of determining whether an individual has a tax home outside the relevant possession under paragraph (d)(1) of this section during any part of the taxable year.

(e) *Closer connection test*. An individual satisfies the requirements of this paragraph (e) for a taxable year if such individual did not have a closer connection to the United States or a foreign country than to the relevant possession. For purposes of the preceding sentence—

(1) The principles of section 7701(b)(3)(B)(ii) and §301.7701(b)–2(d) of this chapter shall apply; and

(2) Another possession shall not be considered a foreign country.

(f) *Examples*. The principles of this section are illustrated by the following examples:

Example 1. Presence test. H and W are U.S. citizens who live for part of the taxable year in a condominium, which they own, located in Possession P. H and W also own a house in State N where they live for 120 days a year to be near their grown children and grandchildren. H and W are retired and their income consists solely of pension payments, dividends, interest, and Social Security benefits. In 2005, H and W are only present in Possession P for a total of 175 days because of a 70 day vacation to Europe and Asia. Thus, in 2005, H and W are not present in Possession P for at least 183 days, are present in the United States for more than 90 days, and have a permanent connection to the United States by reason of their permanent home. However, under paragraph (c)(1)(iii) of this section, H and W each still satisfy the presence test in paragraph (c) of this section with respect to Possession P because they have no earned income in the United States and are physically present for more days in Possession P than in the United States.

Example 2. Presence test. T, a U.S. citizen, is a sales representative for a company based in Possession V. T lives with his wife and minor children in their house in Possession V, where he is also registered to vote. T's business travel requires T to spend 120 days in the United States and another 120 days in foreign countries. When traveling on business, T generally stays at hotels but sometimes stays with his brother, who lives in State A. Under paragraphs (c)(1)(iv) and (c)(4) of this section, T satisfies the presence test in paragraph (c) of this section because he has no permanent connection to the United States.

Example 3. Alien resident of possession— presence test. F is a citizen of Country G. F's tax home is in Possession C and F has no closer connection to the United States or a foreign country than to Possession C. F is physically present in Possession C for 123 days and in the United States for 110 days every year. Accordingly, F is a nonresident alien with respect to the United States under section 7701(b), and a bona fide resident of Possession C under paragraphs (b), (c)(2), (d), and (e) of this section.

Example 4. Seafarers— tax home. S, a U.S. citizen, is employed by a fishery and spends 250 days at sea on a fishing vessel. When not at sea, S resides with his wife at a house they own in Possession G. The fishing vessel upon which S works departs and arrives at various ports in Possession G, other posses-

sions, and foreign countries, but is in international or local waters (within the meaning of paragraph (d)(2) of this section) for 225 days. Under paragraph (d)(2) of this section, S will not be considered to have a tax home outside Possession G for purposes of section 937 and this section solely by reason of S's employment on board the fishing vessel.

Example 5. Seasonal workers— tax home and closer connection. P, a U.S. citizen, is a permanent employee of a hotel in Possession I, but works only during the tourist season. For the remainder of each year, P lives with her husband and children in Possession Q, where she has no outside employment. Most of P's personal belongings, including her automobile, are located in Possession Q. P is registered to vote in, and has a driver's license issued by, Possession Q. P does her personal banking in Possession Q and P routinely lists her address in Possession Q on forms and documents. P satisfies the presence test of paragraph (c) of this section with respect to both Possession Q and Possession I, because, among other reasons, under paragraph (c)(1)(ii) of this section she does not spend more than 90 days in the United States during the taxable year. P satisfies the tax home test of paragraph (d) of this section only with respect to Possession I, because her regular place of business is in Possession I. P satisfies the closer connection test of paragraph (e) of this section with respect to both Possession Q and Possession I, because she does not have a closer connection to the United States or to any foreign country (and for this purpose, under paragraph (e)(2) of this section, Possession Q is not treated as a foreign country with respect to Possession I). Therefore, P is a bona fide resident of Possession I for purposes of the Internal Revenue Code.

Example 6. Closer connection to United States than to possession. Z, a U.S. citizen, relocates to Possession V in 2003 to start an investment consulting and venture capital business. Z's wife and two teen-aged children remain in State C to allow the children to complete high school. Z travels back to the United States regularly to see his wife and children, to engage in business activities, and to take vacations. He has an apartment available for his full-time use in Possession V, but he remains a joint-owner of the residence in State C where his wife and children reside. Z and his family have automobiles and personal belongings such as furniture, clothing, and jewelry located at both residences. Although Z is a member of the Possession V Chamber of Commerce, Z also belongs to and has current relationships with social, political, cultural, and religious organizations in State C. Z receives mail in State C, including brokerage statements, credit card bills, and bank advices. Z is not a bona fide resident of Possession V because he has a closer connection to the United States than to Possession V and therefore fails to satisfy the requirements of paragraphs (b)(1) and (e) of this section.

(g) *Information reporting requirement*. The following individuals are required to file notice of their new tax status in such time and manner as the Commissioner may prescribe by notice, form, instructions, or other publication (see §601.601(d)(2) of this chapter):

(1) Individuals who take the position for U.S. tax reporting purposes that they qualify as bona fide residents of a possession for a tax year subsequent to a tax year for which they were required to file Federal income tax returns as citizens or residents of the United States who did not so qualify.

(2) Citizens and residents of the United States who take the position for U.S. tax reporting purposes that they do not qualify as bona fide residents of a possession for a tax year subsequent to a tax year for which they were required to file income tax returns (with the Internal Revenue Service, the tax authorities of a possession, or both) as individuals who did so qualify.

(3) Bona fide residents of Puerto Rico or a section 931 possession (as defined in §1.931–1T(c)(1)) who take a position for U.S. tax reporting purposes that they qualify as bona fide residents of such possession for a tax year subsequent to a tax year for which they were required to file income tax returns as bona fide residents of the United States Virgin Islands or a section 935 possession (as defined in §1.935–1T(a)(3)(i)).

(h) *Effective date*. Except as provided in this paragraph (h), this section shall apply to taxable years ending after October 22, 2004. Paragraph (g) of this section also applies to the 3 taxable years preceding the first taxable year ending after October 22, 2004.

Par. 30. Section 1.937–2T is added to read as follows:

§1.937–2T Income from sources within a possession (temporary).

(a) *Scope*. Section 937(b) and this section set forth the rules for determining whether income is considered to be from sources within a particular possession (the relevant possession) for purposes of the Internal Revenue Code, including section 957(c) and Subpart D, Part III, Subchapter N, Chapter 1 of the Internal Revenue Code, as well as section 7654(a) of the 1954 Internal Revenue Code (until the effective date of its repeal). Paragraphs (c)(1)(ii) and (c)(2) of this section do not apply, however, for purposes of sections 932(a) and (b) and 935(a)(3) (as in effect before the effective date of its repeal). In the case of a possession or territory that administers income tax laws that are identical (except for the substitution of the name of the possession or territory for the term *United States* where appropriate) to those in force in the United States, these rules do not apply for purposes of the application of such laws. These rules also do not affect the determination of whether income is considered to be from sources without the United States for purposes of the Internal Revenue Code.

(b) *In general*. Except as provided in paragraphs (c) through (i) of this section, the principles of sections 861 through 865 and the regulations thereunder (relating to the determination of the gross and the taxable income from sources within and without the United States) generally shall be applied in determining the gross and the taxable income from sources within and without the relevant possession. In the application of such principles, the name of the relevant possession shall be used instead of the term *United States*, the term *bona fide resident of* followed by the name of the relevant possession shall be used instead of the term *United States resident*, and the term *domestic* shall be construed to mean created or organized in such possession.

(c) *U.S. income*— (1) *In general*. Except as provided in paragraph (d) of this section, income from sources within the relevant possession shall not include any item of income determined under the rules of sections 861 through 865 and the regulations thereunder to be—

(i) From sources within the United States; or

(ii) Effectively connected with the conduct of a trade or business within the United States.

(2) *Conduit arrangements*. Income shall be considered to be from sources within the United States for purposes of paragraph (c)(1) of this section if, pursuant to a plan or arrangement—

(i) The income is received in exchange for consideration provided to another person; and

(ii) Such person (or another person) provides the same consideration (or consideration of a like kind) to a third person in exchange for one or more payments constituting income from sources within the United States.

(d) *Income from certain sales of inventory property*. For special rules that apply to determine the source of income from certain sales of inventory property, see §1.863–3(f).

(e) *Income from services*— (1) *No de minimis rule.* In applying the principles of section 861 and the regulations thereunder pursuant to paragraph (b) of this section, the exception in section 861(a)(3) shall not apply.

(2) *Service in the Armed Forces*. In the case of a member of the Armed Forces of the United States, the following rules shall apply for determining the source of compensation for services performed in compliance with military orders:

(i) If the individual is a bona fide resident of a possession and such services are performed in the United States or in another possession, the compensation constitutes income from sources within the possession of which the individual is a bona fide resident (and not from sources within the United States or such other possession).

(ii) If the individual is not a bona fide resident of a possession and such services are performed in a possession, the compensation constitutes income from sources within the United States (and not from sources within such possession).

(f) *Gains from certain dispositions of property*— (1) *Property of former U.S. residents*. (i) Income from sources within the relevant possession shall not include gains from the disposition of property described in paragraph (f)(1)(ii) of this section by an individual described in paragraph (f)(1)(iii) of this section. See also section 1277(e) of Public Law 99–514 (100 Stat. 2985) (providing that gains from the disposition of certain property by individuals who acquired residency in certain possessions shall be considered to be from sources within the United States).

(ii) Property is described in this paragraph (f)(1)(ii) when the following conditions are satisfied—

(A) The property is of a kind described in section 731(c)(3)(C)(i) or 954(c)(1)(B); and

(B) The property was owned by the individual before such individual became a bona fide resident of the relevant possession.

(iii) An individual is described in this paragraph (f)(1)(iii) when the following conditions are satisfied—

(A) For the taxable year for which the source of the gain must be determined, the individual is a bona fide resident of the relevant possession; and

(B) For any of the 10 years preceding such year, the individual was a citizen or resident of the United States (other than a bona fide resident of the relevant possession).

(iv) If an individual described in paragraph (f)(1)(iii) of this section exchanges property described in paragraph (f)(1)(ii) of this section for other property in a transaction in which gain or loss is not required to be recognized (in whole or in part) under U.S. income tax principles, such other property shall also be considered property described in paragraph (f)(1)(ii) of this section.

(v) If an individual described in paragraph (f)(1)(iii) of this section owns, directly or indirectly, at least 10 percent (by value) of any entity to which property described in paragraph (f)(1)(ii) of this section is transferred in a transaction in which gain or loss is not required to be recognized (in whole or in part) under U.S. income tax principles, any gain recognized upon a disposition of the property by such entity shall be treated as income from sources outside the relevant possession if any gain recognized upon a direct or indirect disposition of the individual's interest in such entity would have been so treated under paragraph (f)(1)(iv) of this section.

(2) *Special rules under section 865 for possessions*— (i) Except as provided in paragraph (f)(1) of this section—

(A) Gain that is considered to be derived from sources outside of the United States under section 865(g)(3) shall be considered income from sources within Puerto Rico; and

(B) Gain that is considered to be derived from sources outside of the United States under section 865(h)(2)(B) shall be considered income from sources within the possession in which the liquidating corporation is created or organized.

(ii) In applying the principles of section 865 and the regulations thereunder pursuant to paragraph (b) of this section, the rules of section 865(g) shall not apply, but the special rule of section 865(h)(2)(B) shall apply with respect to gain recognized upon the liquidation of corporations created or organized in the United States.

(g) *Dividends*— (1) *Dividends from certain possessions corporations*— (i) *In general*. Except as provided in paragraph (g)(1)(ii) of this section, with respect to any possessions shareholder, only the possessions source ratio of any dividend paid or accrued by a corporation created or organized in a possession (possessions corporation) shall be treated as income from sources within such possession. For purposes of this paragraph (g)—

(A) The *possessions source ratio* shall be a fraction, the numerator of which equals the gross income of the possessions corporation from sources within the possession in which it is created or organized (applying the rules of this section) for the testing period, and the denominator of which equals the total gross income of the corporation for the testing period; and

(B) The term *possessions shareholder* means any individual who is a bona fide resident of the possession in which the corporation is created or organized and who owns, directly or indirectly, at least 10 percent of the total voting stock of the corporation.

(ii) *Dividends from corporations engaged in the active conduct of a trade or business in the relevant possession*. The entire amount of any dividend paid or accrued by a possessions corporation shall be treated as income from sources within the possession in which it is created or organized when the following conditions are met—

(A) 80 percent or more of the gross income of the corporation for the testing period was derived from sources within such possession (applying the rules of this section) or was effectively connected with the conduct of a trade or business in such possession (applying the rules of §1.937–3T); and

(B) 50 percent or more of the gross income of the corporation for the testing period was derived from the active conduct of a trade or business within such possession.

(iii) *Testing period*. For purposes of this paragraph (g)(1), the term *testing period* means the 3-year period ending with the close of the taxable year of the payment of the dividend (or for such part of such period as the corporation has been in existence).

(iv) *Subsidiary look-through rule*. For purposes of this paragraph (g)(1), if a possessions corporation owns (directly or indirectly) at least 25 percent (by value) of the stock of another corporation, such possessions corporation shall be treated as if it—

(A) Directly received its proportionate share of the income of such other corporation; and

(B) Actively conducted any trade or business actively conducted by such other corporation.

(2) *Dividends from other corporations*. In applying the principles of section 861 and the regulations thereunder pursuant to paragraph (b) of this section, the special rules relating to dividends for which deductions are allowable under section 243 or 245 shall not apply.

(h) *Income inclusions*. For purposes of determining whether an amount described in section 904(h)(1)(A) constitutes income from sources within the relevant possession—

(1) If the individual owns (directly or indirectly) at least 10 percent of the total voting stock of the corporation from which such amount is derived, the principles of section 904(h)(2) shall apply. In the case of an individual who is not a possessions shareholder (as defined in paragraph (g)(1)(i)(B) of this section), the preceding sentence shall apply only if the corporation qualifies as a *United States-owned foreign corporation* for purposes of section 904(h); and

(2) In all other cases, the amount shall be considered income from sources in the jurisdiction in which the corporation is created or organized.

(i) *Interest*— (1) *Interest from certain possessions corporations*— (i) *In general*. Except as provided in paragraph (i)(1)(ii) of this section, with respect to any possessions shareholder (as defined in paragraph (g)(1)(i)(B) of this section), interest paid or accrued by a possessions corporation shall be treated as income from sources within the possession in which it is created or organized to the extent that such interest is allocable to assets that generate, have generated, or could reasonably have been expected to generate income from sources within such possession (under the rules of this section) or income effectively connected with the conduct of a trade or business within such possession (under the rules of §1.937–3T). For purposes of the preceding sentence, the principles of §§1.861–9 through 1.861–12 shall apply.

(ii) *Interest from corporations engaged in the active conduct of a trade or business in the relevant possession*. The entire amount of any interest paid or accrued by a possessions corporation shall be treated as income from sources within the possession in which it is created or organized when the conditions of paragraphs (g)(1)(ii)(A) and (B) of this section are met (applying the rules of paragraphs (g)(1)(iii) and (iv) of this section).

(2) *Interest from partnerships*. Interest paid or accrued by a partnership shall be treated as income from sources within a possession only to the extent that such interest is allocable to income effectively connected with the conduct of a trade or business in such possession. For purposes of the preceding sentence, the principles of §1.882–5 shall apply (as if the partnership were a foreign corporation and as if the trade or business in the possession were a trade or business in the United States).

(j) *Indirect ownership*. For purposes of this section, the rules of section 318(a)(2) shall apply except that the language "5 percent" shall be used instead of "50 percent" in section 318(a)(2)(C).

(k) *Examples*. The provisions of this section may be illustrated by the following examples:

Example 1. X, a U.S. citizen, resides in State N and acquires the stock of Corporation C, a domestic corporation, in 2000. X moves to the Northern Mariana Islands (NMI) in 2003. In 2004, while a bona fide resident of the NMI, X recognizes gain on the sale of the Corporation C stock. Pursuant to section 1277(e) of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085) (October 22, 1986), this gain is treated as income from sources within the United States for all purposes of the Internal Revenue Code (including section 7654, as in effect with respect to the NMI), and not as income from sources in the NMI.

Example 2. X, a U.S. citizen, resides in State F and acquires a 5 percent interest in Partnership P in 2003. X moves to the U.S. Virgin Islands (USVI) in 2004. In 2006, while a bona fide resident of the USVI, X recognizes gain on the sale of the interest in Partnership P. Pursuant to paragraph (f)(1) of this section, the gain shall not be treated as income from sources within the USVI for purposes of the Internal Revenue Code (for example, for purposes of section 934(b)).

Example 3. X, a bona fide resident of Possession I, a section 931 possession (as defined in §1.931–1T(c)(1)), is engaged in a trade or business in the United States through an office in State H. In 2005, this office materially participates in the sale of inventory property in Possession I, such that the income from these inventory sales is considered effectively connected to this trade or business in the United States under section 864(c)(4)(B)(iii). This income shall not be treated as income from sources within Possession I for purposes of section 931(a)(1) pursuant to paragraph (c)(1)(ii) of this section, but nonetheless shall continue to be treated as income from sources without the United States under section 862 (for example, for purposes of section 904).

Example 4. (i) X, a bona fide resident of Possession I, owns 25 percent of the outstanding shares of A Corp, a corporation organized under the laws of Possession I. In 2006, X receives a dividend of $70x from A Corp. During 2004 through 2006, A Corp has gross income from the following sources:

	Possession I Sources	*Sources Outside Possession I*
2004	$10x	$20x
2005	20x	10x
2006	25x	15x

(ii) A Corp owns 50 percent of the outstanding shares of B Corp, a corporation organized under the laws of Country FC. During 2004 through 2006, B Corp has gross income from the following sources:

	Possession I Sources	*Sources Outside Possession I*
2004	$10x	$6x
2005	14x	8x
2006	10x	4x

(iii) A Corp is treated as having received 50 percent of the gross income of B Corp. Therefore, for 2004 through 2006, the gross income of A Corp is from the following sources:

	Possession I Sources	*Sources Outside Possession I*
2004	$15x	$23x
2005	27x	14x
2006	30x	17x
Totals	$72x	$54x

(iv) Pursuant to paragraph (g) of this section, the portion of the dividend of $70x that X receives from Corp A in 2006 that is treated as income from sources within Possession I is 72/126 of $70x, or $40x.

Example 5. X is a U.S. citizen and a bona fide resident of the Northern Mariana Islands (NMI). In 2005, X receives compensation for services performed as a member of the crew of a fishing boat. Ten percent of the services for which X receives compensation are performed in the NMI, and 90 percent of X's services are performed in international waters. X is a "United States person" as defined in section 7701(a)(30)(A). Accordingly, pursuant to section 863(d)(1)(A), the compensation that X receives for services performed in international waters is treated as income from sources within the United States for purposes of the Internal Revenue Code (including section 7654, as in effect with respect to the NMI). Under the principles of section 861(a)(3) as applied pursuant to paragraph (b) of this section, the compensation that X receives for services performed in the NMI is treated as income from sources within the NMI.

(l) *Effective date*. Except as otherwise provided in this paragraph (l), this section applies to income earned in tax years ending after October 22, 2004. Paragraph (c)(1) of this section applies to income earned after December 31, 2004. Paragraph (f) of this section applies to dispositions after April 11, 2005. Paragraphs (c)(2), (g)(1), (h), and (i) of this section apply to amounts paid or accrued after April 11, 2005.

Par. 31. Section 1.937–3T is added to read as follows:

§1.937–3T Income effectively connected with the conduct of a trade or business in a possession (temporary).

(a) *Scope*. Section 937(b) and this section set forth the rules for determining whether income is effectively connected with the conduct of a trade or business within a particular possession (the relevant possession) for purposes of the Internal Revenue Code, including sections 881(b) and 957(c) and Subpart D, Part III, Subchapter N, Chapter 1 of the Internal Revenue Code. Paragraph (c) of this section does not apply, however, for purposes of section 881(b). In the case of a possession or territory that administers income tax laws that are identical (except for the substitution of the name of the possession or territory for the term *United States* where appropriate) to those in force in the United States, these rules do not apply for purposes of the application of such laws.

(b) *In general*. Except as provided in paragraphs (c) and (d) of this section, the principles of section 864(c) and the regulations thereunder (relating to the determination of income, gain or loss which is effectively connected with the conduct of a trade or business within the United States) shall generally be applied in determining whether income is effectively connected with the conduct of a trade or business within the relevant possession (except for the substitution of the name of the relevant possession for the term *United States* where appropriate), without regard to whether the taxpayer qualifies as a nonresident alien individual or a foreign corporation with respect to such possession. For purposes of the preceding sentence, all income other than income from sources within the relevant possession (as determined under the rules of §1.937–2T) shall be considered income from sources without the relevant possession, and subject to the rules of this section, the principles of section 864(c)(4) shall apply for purposes of determining whether such income constitutes income effectively connected with the conduct of a trade or business in the relevant possession.

(c) *U.S. income*— (1) *In general*. Except as provided in paragraph (d) of this section, income considered to be effectively connected with the conduct of a trade or business within the relevant possession shall not include any item of income determined under the rules of sections 861 through 865 and the regulations thereunder to be—

(i) From sources within the United States; or

(ii) Effectively connected with the conduct of a trade or business within the United States.

(2) *Conduit arrangements*. Income shall be considered to be from sources within the United States for purposes of paragraph (c)(1) of this section if, pursuant to a plan or arrangement—

(i) The income is received in exchange for consideration provided to another person; and

(ii) Such person (or another person) provides the same consideration (or consideration of a like kind) to a third person in exchange for one or more payments constituting income from sources within the United States.

(d) *Income from certain sales of inventory property*. Paragraph (c) of this section shall not apply to income from sales of inventory property described in §1.863–3(f).

(e) *Examples*. The provisions of this section may be illustrated by the following examples:

Example 1. X is a bona fide resident of Possession I, a section 931 possession (as defined in §1.931–1T(c)(1)). X has an office in Possession I from which X conducts a business consisting of the development and sale of specialized computer software. A purchaser of software will frequently pay X an additional amount to install the software on the purchaser's operating system and to ensure that the software is functioning properly. X performs the installation services at the purchaser's place of business which may be in Possession I, in the United States, or in another country. The provision of such services is not *de minimis* and constitutes a separate transaction under the rules of §1.861–18. Under the principles of section 864(c)(4) as applied pursuant to paragraph (b) of this section, the compensation that X receives for personal services performed outside of Possession I is not considered to be effectively connected with the conduct of a trade or business in Possession I for purposes of section 931(a)(2).

Example 2. (i) F Bank is organized under the laws of Country FC and operates an active banking business from offices in the U.S. Virgin Islands (USVI). In connection with this banking business, F Bank makes loans to and receives interest payments from borrowers who reside in the USVI, in the United States, and in Country FC.

(ii) Under the principles of section 861(a)(1) as applied pursuant to §1.937–2T(b), interest payments

received by F Bank from borrowers who reside in the United States or in Country FC constitute income from sources outside of the USVI. Under the principles of section 864(c)(4) as applied pursuant to paragraph (b) of this section, interest income from sources outside of the USVI generally may constitute income that is effectively connected with the conduct of a trade or business within the USVI for purposes of the Internal Revenue Code. However, interest payments received by F Bank from borrowers who reside in the United States constitute income from sources within the United States under section 861(a)(1). Accordingly, under paragraph (c)(1) of this section, such interest income shall not be treated as effectively connected with the conduct of a trade or business in the USVI for purposes of the Internal Revenue Code (for example, for purposes of section 934(b)). Interest payments received by F Bank from borrowers who reside in Country FC, however, may be treated as effectively connected with the conduct of a trade or business in the USVI for purposes of the Internal Revenue Code (including section 934(b)).

(iii) To the extent that, as described in section 934(a), the USVI administers income tax laws that are identical (except for the substitution of the name of the USVI for the term *United States* where appropriate) to those in force in the United States, interest payments received by F Bank from borrowers who reside in the United States or in Country FC may be treated as income that is effectively connected with the conduct of a trade or business in the USVI for purposes of F Bank's income tax liability to the USVI under mirrored section 882.

Example 3. (i) G is a partnership that is organized under the laws of, and that operates an active financing business from offices in, Possession I. Interests in G are owned by D, a bona fide resident of Possession I, and N, an alien individual who resides in Country FC. Pursuant to a pre-arrangement, G loans $x to T, a business entity organized under the laws of Country FC, and T in turn loans $y to E, a U.S. resident. In accordance with the arrangement, E pays interest to T, which in turn pays interest to G.

(ii) The arrangement constitutes a conduit arrangement under paragraph (c)(2) of this section, and the interest payments received by G are treated as income from sources within the United States for purposes of paragraph (c)(1) of this section. Accordingly, the interest received by G shall not be treated as effectively connected with the conduct of a trade or business in Possession I for purposes of the Internal Revenue Code (including sections 931(a)(2) and 934(b), if applicable with respect to D). Whether such interest constitutes income from sources within the United States for other purposes of the Internal Revenue Code under generally applicable conduit principles will depend on the facts and circumstances. See, for example, *Aiken Indus., Inc. v. Commissioner*, 56 T.C. 925 (1971).

(iii) If Possession I administers income tax laws that are identical (except for the substitution of the name of the possession for the term *United States* where appropriate) to those in force in the United States, the interest received by G may be treated as income effectively connected with the conduct of a trade or business in Possession I under mirrored section 864(c)(4) for purposes of determining the Possession I territorial income tax liability of N under mirrored section 871.

(f) *Effective date.* Except as otherwise provided in this paragraph (f), this section applies to income earned in taxable years ending after October 22, 2004. Paragraph (c)(1) of this section applies to income earned after December 31, 2004. Paragraph (c)(2) of this section applies to amounts paid or accrued after April 11, 2005.

Par. 32. Section 1.957–3 is revised to read as follows:

§1.957–3 United States person defined.

[Reserved]. For further guidance, see §1.957–3T.

Par. 33. Section 1.957–3T is added to read as follows:

§1.957–3T United States person defined (temporary).

(a) *Basic rule*— (1) *In general.* The term *United States person* has the same meaning for purposes of sections 951 through 965 which it has under section 7701(a)(30) and the regulations thereunder, except as provided in paragraphs (b) and (c) of this section which provide, with respect to corporations organized in possessions of the United States, that certain residents of such possessions are not United States persons. The effect of determining that an individual is not a United States person for such purposes is to exclude such individual in determining whether a foreign corporation created or organized in, or under the laws of, a possession of the United States is a controlled foreign corporation. See §1.957–1 for the definition of the term *controlled foreign corporation*.

(2) *Special provisions applicable to possessions of the United States.* For purposes of this section—

(i) The term *possession of the United States* means the Commonwealth of Puerto Rico (Puerto Rico) or any section 931 possession.

(ii) The term *section 931 possession* has the same meaning which it has under §1.931–1T(c)(1).

(iii) The rules of §1.937–1T shall apply for determining whether an individual is a bona fide resident of a possession of the United States.

(iv) The rules of §1.937–2T shall apply for determining whether income is from sources within a possession of the United States.

(v) The rules of §1.937–3T shall apply for determining whether income is effectively connected with the conduct of a trade or business in a possession of the United States.

(b) *Puerto Rico corporation and resident.* An individual (who, without regard to this paragraph (b), is a United States person) shall not be considered a United States person with respect to a foreign corporation created or organized in, or under the laws of, Puerto Rico for the taxable year of such corporation which ends with or within the taxable year of such individual if—

(1) Such individual is a bona fide resident of Puerto Rico during his entire taxable year in which or with which the taxable year of such foreign corporation ends; and

(2) A dividend received by such individual from such corporation during the taxable year of such corporation would, for purposes of section 933(1), be treated as income derived from sources within Puerto Rico.

(c) *Section 931 possession corporation and resident.* An individual (who, without regard to this paragraph (c), is a United States person) shall not be considered a United States person with respect to a foreign corporation created or organized in, or under the laws of, a section 931 possession for the taxable year of such corporation which ends with or within the taxable year of such individual if—

(1) Such individual is a bona fide resident of such section 931 possession during his entire taxable year in which or with which the taxable year of such foreign corporation ends; and

(2) Such corporation satisfies the following conditions—

(i) 80 percent or more of its gross income for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within section 931 possessions or was effectively connected with the conduct of a trade or business in section 931 possessions; and

(ii) 50 percent or more of its gross income for such period (or part) was derived from the active conduct of a trade or business within section 931 possessions.

(d) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

§1.957–4 [Removed]

Par. 34. Section 1.957–4 is removed.

Par. 35. In §1.1402(a)–11, paragraph (b) is revised to read as follows:

§1.1402(a)–11 Ministers and members of religious orders.

* * * * *

(b) *In employ of American employer*. If a minister or member of a religious order engaged in a trade or business described in section 1402(c) and §1.1402(c)–5 is a citizen of the United States and performs service, in his capacity as a minister or member of a religious order, as an employee of an American employer, as defined in section 3121(h) and the regulations thereunder in Part 31 of this chapter (Employment Tax Regulations), his net earnings from self-employment derived from such service shall be computed as provided in paragraph (a) of this section but without regard to the exclusions from gross income provided in section 911, relating to earned income from sources without the United States, and section 931, relating to income from sources within certain possessions of the United States. Thus, even though all the income of the minister or member for service of the character to which this paragraph is applicable was derived from sources without the United States, or from sources within certain possessions of the United States, and therefore may be excluded from gross income, such income is included in computing net earnings from self-employment.

* * * * *

Par. 36. Section 1.1402(a)–12 is revised to read as follows:

§1.1402(a)–12 Continental shelf and certain possessions of the United States.

[Reserved]. For further guidance, see §1.1402(a)–12T.

Par. 37. Section 1.1402(a)–12T is added to read as follows:

§1.1402(a)–12T Continental shelf and certain possessions of the United States (temporary).

(a) *Certain possessions*. For purposes of the tax on self-employment income, the exclusion from gross income provided by section 931 (relating to bona fide residents of certain possessions of the United States) shall not apply. Net earnings from self-employment are subject to the tax on self-employment income even if such amounts are excluded from gross income under section 931.

(b) *Continental shelf*. For the definition of the term *United States* and for other geographical definitions relating to the continental shelf, see section 638 and §1.638–1.

(c) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 38. In §1.6038–2, paragraph (d) is revised to read as follows:

§1.6038–2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(d) [Reserved]. For further guidance, see §1.6038–2T(d).

Par. 39. Section 1.6038–2T is added to read as follows:

§1.6038–2T Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations (temporary).

(a) through (c) [Reserved]. For further guidance, see §1.6038–2(a) through (c).

(d) *U.S. person*— (1) *In general*. For purposes of section 6038 and this section, the term *United States person* has the meaning assigned to it by section 7701(a)(30), except as provided in paragraphs (d)(2) and (3) of this section.

(2) *Special rule for individuals residing in certain possessions*. With respect to individuals who are bona fide residents of Puerto Rico or any section 931 possession, as defined in §1.931–1T(c)(1), the term United States person has the meaning assigned to it by §1.957–3T.

(3) *Special rule for certain nonresident aliens*. An individual for whom an election under section 6013(g) or (h) is in effect shall, subject to the exceptions contained in paragraph (d)(2) of this section, be considered a United States person for purposes of section 6038 and this section.

(e) through (l)(2) [Reserved]. For further guidance, see §1.6038–2(e) through (l)(2).

(m) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 40. Section 1.6046–1 is amended as follows:

1. Revise the heading.

2. Revise paragraph (f)(3).

3. Remove the undesignated paragraph that follows paragraph (f)(3)(iii).

The revisions are as follows:

§1.6046–1 Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.

* * * * *

(f)(3) [Reserved]. For further guidance, see §1.6046–1T(f)(3).

* * * * *

Par. 41. Section 1.6046–1T is added to read as follows:

§1.6046–1T Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock (temporary).

(a) through (f)(2) [Reserved]. For further guidance, see §1.6046–1(a) through (f)(2).

(f)(3) *U.S. person*— (i) *In general*. For purposes of section 6046 and this section, the term *United States person* has the meaning assigned to it by section 7701(a)(30), except as provided in paragraphs (f)(3)(ii) and (iii) of this section.

(ii) *Special rule for individuals residing in certain possessions*. With respect to individuals who are bona fide residents of Puerto Rico or any section 931 possession, as defined in §1.931–1T(c)(1), the term United States person has the meaning assigned to it by §1.957–3T.

(iii) *Special rule for certain nonresident aliens*. An individual for whom an election under section 6013(g) or (h) is in effect shall, subject to the exceptions contained in paragraph (f)(3)(ii) of this section, be considered a United States person for purposes of section 6046 and this section.

(f)(4) through (k) [Reserved]. For further guidance, see §1.6046–1(f)(4) through (k).

(l) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

PART 301 — PROCEDURE AND ADMINISTRATION

Par. 42. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 43. Section 301.6688–1 is revised to read as follows:

§301.6688–1 Assessable penalties with respect to information required to be furnished with respect to possessions.

[Reserved]. For further guidance, see §301.6688–1T.

Par. 44. Section 301.6688–1T is added to read as follows:

§301.6688–1T Assessable penalties with respect to information required to be furnished with respect to possessions (temporary).

(a) *In general*. Each individual who is subject to an information reporting requirement promulgated under the authority of section 937(c) or 7654 and who fails to fully satisfy such requirement within the time prescribed for reporting such information shall, in addition to any criminal penalty provided by law, pay a penalty of $1000 for each such failure. Information reporting requirements promulgated under the authority of sections 937(c) and 7654(e) include the following:

(1) The requirement to file Form 8689, "*Allocation of Individual Income Tax to the Virgin Islands*," under §1.932–1T(b)(1) of this chapter, for certain individuals with income from sources within the United States Virgin Islands.

(2) [Reserved].

(3) [Reserved].

(4) The requirement for individuals to report that they became or ceased to be a bona fide resident of a possession under §1.937–1T(g) of this chapter.

(b) *Manner of payment*. The penalty set forth in paragraph (a) of this section shall be paid in the same manner as tax upon the issuance of a notice and demand therefor.

(c) *Reasonable cause*— (1) *In general*. The penalty set forth in paragraph (a) of this section shall not apply if it is established to the satisfaction of the appropriate tax authority (as defined in paragraph (c)(2) of this section) that the failure to file the information return or furnish the information within the prescribed time was due to reasonable cause and not to willful neglect. An individual who wishes to avoid the penalty must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the information return on time, or furnish the information on time, in the form of a written statement containing a declaration that it is made under penalties of perjury. Such statement must be filed with the appropriate tax authority. In determining whether there was reasonable cause for failure to furnish the required information, account will be taken of the fact that the individual was unable to furnish the required information in spite of the exercise of ordinary business care and prudence in his effort to furnish the information. An individual will be considered to have exercised ordinary business care and prudence in his effort to furnish the required information if he made reasonable efforts to furnish the information but was unable to do so because of a lack of sufficient facts on which to make a proper determination.

(2) *Appropriate tax authority*. For purposes of this section, the appropriate tax authority is the person responsible for tax administration in the jurisdiction to which the information is required to be provided. Thus, in the case of information required under section 937(c) or under section 7654 to be provided to the Internal Revenue Service, the appropriate tax authority is the Commissioner. In the case of information required under section 7654 (as in effect with respect to section 935 possessions (as defined in §1.935–1T(a)(3)(i) of this chapter)) to be provided to the tax authorities of a section 935 possession, the appropriate tax authority is the person responsible for tax administration in such possession or his delegate. See §1.935–1(b) of this chapter for the rules that specify where returns of income tax must be filed for the taxable year by individuals to whom section 935 applies.

(d) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

Par. 45. In §301.7701(b)–1, paragraph (d) is revised to read as follows:

§301.7701(b)–1 Resident alien.

* * * * *

(d) [Reserved]. For further guidance, see §301.7701(b)–1T(d).

* * * * *

Par. 46. Section 301.7701(b)–1T is added to read as follows:

§301.7701(b)–1T Resident alien (temporary).

(a) through (c) [Reserved]. For further guidance, see §301.7701(b)–1(a) through (c).

(d) *Application of section 7701(b) to the possessions and territories*— (1) *Application to aliens for purposes of mirror systems*. Section 7701(b) provides the basis for determining whether an alien individual is a resident of a United States possession or territory that administers income tax laws that are identical (except for the substitution of the name of the possession or territory for the term *United States* where appropriate) to those in force in the United States, for purposes of applying such laws with respect to income tax liability incurred to such possession or territory.

(2) *Non-application for bona fide resident determination*. Section 7701(b) does not provide the basis for determining whether an individual (including an alien individual) is a bona fide resident of a United States possession or territory for U.S. Federal income tax purposes. For the applicable rules for making this determination, see section 937(a) and the regulations thereunder.

(e) [Reserved]. For further guidance, see §301.7701(b)–1(e).

(f) *Effective date*. This section shall apply for taxable years ending after October 22, 2004.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 47. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 48. In §602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.937–1T	1545–1930
* * * * *	

Linda M. Kroening,
Acting Deputy Commissioner for Services and Enforcement.

Approved March 25, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 6, 2005, 11:05 a.m., and published in the issue of the Federal Register for April 11, 2005, 70 F.R. 18919)

Section 1014.—Basis of Property Acquired From a Decedent

26 CFR 1.1014–1: Basis of property acquired from a decedent.

How a death benefit received by the beneficiary of a deferred annuity contract after the death of the owner-annuitant will be treated under section 1014. See Rev. Rul. 2005-30, page 1015.

Part III. Administrative, Procedural, and Miscellaneous

Renewable Electricity Production Credit and Refined Coal Production Credit, Publication of Inflation Adjustment Factor and Reference Prices for Calendar Year 2005

Notice 2005–37

This notice publishes the inflation adjustment factor and reference prices for calendar year 2005 for the renewable electricity production credit and the refined coal production credit under § 45 of the Internal Revenue Code. The 2005 inflation adjustment factor and reference prices are used in determining the availability of the credits. The 2005 inflation adjustment factor and reference prices apply to calendar year 2005 sales of kilowatt-hours of electricity produced in the United States or a possession thereof from qualified energy resources and to calendar year 2005 sales of refined coal produced in the United States or a possession thereof.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under § 45(a) is reduced by an amount that bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents, bears to (B) 3 cents. Under § 45(b)(2), the 1.5 cents in § 45(a) and the 8 cents in § 45(b)(1) are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, and municipal solid waste.

Section 45(d)(1) defines a qualified facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and before January 1, 2006. (See § 45(e)(7) for rules relating to the inapplicability of the credit to electricity sold to utilities under certain contracts.)

Section 45(d)(2)(A) defines a qualified facility using closed-loop biomass to produce electricity as (i) any facility owned by the taxpayer that is originally placed in service after December 31, 1992, and before January 1, 2006, or (ii) any facility owned by the taxpayer which before January 1, 2006, is originally placed in service and modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation as described in 65 Fed. Reg. 63052. Section 45(d)(2)(B) provides that in the case of a qualified facility described in § 45(d)(2)(A)(ii), (i) the 10-year period referred to in § 45(a) is treated as beginning no earlier than the date of enactment of § 45(d)(2)(B); (ii) the amount of the credit determined under § 45(a) with respect to the facility is an amount equal to an amount determined without regard to § 45(d)(2)(B) multiplied by the ratio of the thermal content of the closed-loop biomass used in such facility to the thermal content of all fuels used in such facility; and (iii) if the owner of such facility is not the producer of electricity, the person eligible for the credit allowable under § 45(a) will be the lessee or the operator of the facility.

Section 45(d)(3) defines a qualified facility using open-loop biomass to produce electricity as any facility owned by the taxpayer which (i) in the case of a facility using agricultural livestock waste nutrients, (I) is originally placed in service after the date of enactment of § 45(d)(3)(A)(i)(I) and before January 1, 2006, and (II) the nameplate capacity rating of which is not less than 150 kilowatts; and (ii) in the case of any other facility, is originally placed in service before January 1, 2006. In the case of any facility described in §45(d)(3)(A), if the owner of the facility is not the producer of the electricity, § 45(d)(3)(B) provides that the person eligible for the credit allowable under § 45(a) will be the lessee or the operator of the facility.

Section 45(d)(4) defines a qualified facility using geothermal or solar energy to produce electricity as any facility owned by the taxpayer that is originally placed in service after the date of enactment of § 45(d)(4) and before January 1, 2006. A qualified facility using geothermal or solar energy must not include any property described in § 48(a)(3) the basis of which is taken into account by the taxpayer for purposes of determining the energy credit under § 48.

Section 45(d)(5) defines a qualified facility using small irrigation power to produce electricity as any facility owned by the taxpayer that is originally placed in service after the date of enactment of § 45(d)(5) and before January 1, 2006.

Section 45(d)(6) defines a qualified facility using gas derived from the biodegradation of municipal solid waste to produce electricity as any facility owned by the taxpayer that is originally placed in service after the date of enactment of § 45(d)(6) and before January 1, 2006.

Section 45(d)(7) defines a qualified facility that burns municipal solid waste to produce electricity as any facility owned by the taxpayer that is originally placed in service after the date of enactment of § 45(d)(7) and before January 1, 2006.

Section 45(e)(8)(A) provides that the refined coal production credit is an amount equal to $4.375 per ton of qualified refined coal (i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and (ii) sold by the taxpayer to an unrelated person during such 10-year period and such taxable year. Section 45(e)(8)(B) provides that the amount of credit determined under § 45(e)(8)(A) is reduced by an amount which bears the same ratio to the amount of credit determined under § 45(e)(8)(A) (determined without regard to § 45(e)(8)(B)) as (i) the amount by which the reference price of fuel used as feedstock (within the meaning

of § 45(c)(7)(A)) for the calendar year in which the sale occurs exceeds an amount equal to 1.7 multiplied by the reference price for such fuel in 2002, bears to (ii) $8.75.

Under § 45(b)(2), the $4.375 amount in § 45(e)(8)(A), and in § 45(e)(8)(B)(i) the reference price of fuel used as feedstock (within the meaning of § 45(c)(7)(A)) in 2002 are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs.

Section 45(d)(8) defines a refined coal production facility as a facility that is placed in service after the date of enactment of 45(d)(8) and before January 1, 2009.

Section 45(e)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factor and the reference prices for the calendar year. The inflation adjustment factor and the reference prices for the 2005 calendar year were published in the Federal Register on April 8, 2005, (70 Fed. Reg. 18071).

Section 45(e)(2)(B) defines the inflation adjustment factor for a calendar year as the fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Section 45(e)(2)(C) provides that the reference price is the Secretary's determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United States. Only contracts entered into after December 31, 1989, are taken into account.

Under § 45(e)(8)(C), the determination of the reference price for fuel used as feedstock within the meaning of § 45(c)(7)(A) is made according to rules similar to the rules under § 45(e)(2)(C).

INFLATION ADJUSTMENT FACTOR AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2005 is 1.2528. The reference price for calendar year 2005 for facilities producing electricity from wind is 4.85¢ per kilowatt hour. The reference prices for fuel used as feedstock within the meaning of § 45(c)(7)(A) (relating to refined coal production) are $31.90 per ton for calendar year 2002 and $36.36 per ton for calendar year 2005. The reference prices for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, and municipal solid waste have not been determined for calendar year 2005. The IRS is exploring methods of determining those reference prices for calendar year 2006.

PHASE-OUT CALCULATION

Because the 2005 reference price for electricity produced from wind does not exceed 8¢ multiplied by the inflation adjustment factor, the phaseout of the credit provided in § 45(b)(1) does not apply to such electricity sold during calendar year 2005. Because the 2005 reference price of fuel used as feedstock for refined coal does not exceed the $31.90 reference price of such fuel in 2002 multiplied by the inflation adjustment factor and 1.7, the phaseout of credit provided in § 45(e)(8)(B) does not apply to refined coal sold during calendar year 2005. Further, for electricity produced from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, and municipal solid waste, the phaseout of credit provided in § 45(b)(1) does not apply to such electricity sold during calendar year 2005.

CREDIT AMOUNT BY QUALIFIED ENERGY RESOURCE AND FACILITY, AND REFINED COAL

As required by § 45(b)(2), the 1.5¢ amount in § 45(a)(1), the 8¢ amount in § 45(b)(1), and the $4.375 amount in § 45(e)(8)(A) are each adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1¢, such amount is rounded to the nearest multiple of 0.1¢. In the case of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities, § 45(b)(4)(A) requires the amount in effect under § 45(a)(1) (before rounding to the nearest 0.1¢) to be reduced by one-half. Under the calculation required by § 45(b)(2), the credit for renewable electricity production for calendar year 2005 under § 45(a) is 1.9¢ per kilowatt hour on the sale of electricity produced from the qualified energy resources of wind, closed-loop biomass, geothermal energy, and solar energy, and 0.9¢ per kilowatt hour on the sale of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. Under the calculation required by § 45(b)(2), the credit for refined coal production for calendar year 2005 under section 45(e)(8)(A) is $5.481 per ton on the sale of qualified refined coal.

DRAFTING AND CONTACT INFORMATION

The principal author of this notice is David A. Selig of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Selig at (202) 622–3040 (not a toll-free call).

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26 CFR 301.7508–1: Time for performing certain acts postponed by reason of service in a combat zone or a Presidentially declared disaster.
(Also Part I, §§ 7508, 7508A; §§ 301.7508–1, 301.7508A–1.)

Rev. Proc. 2005–27

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 This revenue procedure provides an updated list of time-sensitive acts, the performance of which may be postponed under sections 7508 and 7508A of the Internal Revenue Code (Code). Section 7508 of the Code postpones the time to perform specified acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces, in a combat zone, or serving with respect to a contingency operation (as defined in 10 U.S.C. 101(a)(3)). Section 7508A of the Code permits a postponement of the

time to perform specified acts for taxpayers affected by a Presidentially declared disaster or a terroristic or military action. The list of acts in this revenue procedure supplements the list of postponed acts in section 7508(a)(1) of the Code and section 301.7508A–1(b) of the Regulations on Procedure and Administration.

.02 This revenue procedure does not, by itself, provide any postponements under section 7508A. In order for taxpayers to be entitled to a postponement of any act listed in this revenue procedure, the IRS generally will publish a Notice or issue other guidance (including an IRS News Release) providing relief with respect to a Presidentially declared disaster, or a terroristic or military action.

.03 For purposes of section 7508, this revenue procedure sets forth such other acts as contemplated by section 7508(a)(1)(K). Unlike section 7508A, when a taxpayer qualifies under section 7508, all the acts listed in section 7508(a)(1) are postponed. Therefore, when a taxpayer qualifies under section 7508, the acts listed in this revenue procedure are also postponed for that taxpayer, whether or not the IRS publishes a Notice or issues other guidance.

.04 This revenue procedure will be updated as needed when the IRS determines that additional acts should be included in the list of postponed acts or that certain acts should be removed from the list. Also, taxpayers may recommend that additional acts be considered for postponement under sections 7508 and 7508A. *See* section 19 of this revenue procedure.

.05 Significant Changes

(1) This Revenue Procedure clarifies that the acts listed below are automatically postponed for taxpayers afforded relief pursuant to section 7508.

(2) New section 17 expands the categories of taxpayers qualifying for relief, and provides additional postponements of deadlines solely with respect to section 1031 like-kind exchange transactions that are affected by a Presidentially declared disaster.

SECTION 2. BACKGROUND

.01 Section 7508(a)(1) of the Internal Revenue Code permits a postponement of certain time-sensitive acts for individuals serving in the Armed Forces or in support of such Armed Forces in an area designated by the President as a combat zone under section 112 or serving with respect to a contingency operation (as defined in 10 U.S.C. 101(a)(3)). Among these acts are the filing of returns, the payment of tax, the filing of a Tax Court petition, and the filing of a refund claim. In the event of service in a combat zone or service with respect to a contingency operation, the acts specified in section 7508(a)(1) of the Code are *automatically postponed*. This revenue procedure sets forth such other acts as contemplated by section 7508(a)(1)(K). Thus, the acts listed in this revenue procedure are also automatically postponed. In addition, the Service may include acts not listed in this revenue procedure in any other published guidance (including an IRS News Release) related to the combat zone or contingency operation.

.02 Section 7508A of the Code provides that certain acts performed by taxpayers and the government may be postponed if the taxpayer is affected by a Presidentially declared disaster or a terroristic or military action. A "Presidentially declared disaster" is defined in section 1033(h)(3) of the Code. A "terroristic or military action" is defined in section 692(c)(2) of the Code. Section 301.7508A–1(d)(1) of the regulations defines seven types of affected taxpayers, including any individual whose principal residence (for purposes of section 1033(h)(4)) is located in a "covered disaster area" and any business entity or sole proprietor whose principal place of business is located in a "covered disaster area." Postponements under section 7508A are not available simply because a disaster or a terroristic or military action has occurred. Generally, the IRS will publish a Notice or issue other guidance (including an IRS News Release) authorizing the postponement. Such guidance will describe the *acts* postponed, the *duration* of the postponement, and the *location* of the covered disaster area. *See*, for example, Notice 2001–68, 2001–2 C.B. 504, *supplementing* Notice 2001–61, 2001–2 C.B. 305. When a Notice or other guidance for a particular disaster is published, or issued, the guidance generally will refer to this revenue procedure and may provide for a postponement of all the acts listed in the regulations and this revenue procedure. Alternatively, the guidance may provide that only certain acts listed in this revenue procedure are postponed based on the time when the disaster occurred, its severity, and other factors.

SECTION 3. SCOPE

This revenue procedure applies to individuals serving in the Armed Forces in a combat zone, or in support of such Armed Forces, individuals serving with respect to contingency operations, affected taxpayers by reason of Presidentially declared disasters within the meaning of section 301.7508A–1(d)(1) of the regulations, and taxpayers whom the IRS determines are affected by a terroristic or military action.

SECTION 4. APPLICATION

.01 The tables below list provisions of the internal revenue laws requiring the timely performance of specified acts that may be postponed under sections 7508 and 7508A. In addition, section 17 of this revenue procedure expands the categories of taxpayers qualifying for relief and provides additional postponements of deadlines solely with respect to section 1031 like-kind exchange transactions that are affected by a Presidentially declared disaster. Taxpayers may use the postponement rules provided in section 17 in lieu of the general extension dates provided by an IRS News Release or other guidance issued with respect to a specific Presidentially declared disaster. Taxpayers who are covered by the rules of section 17, but who are not otherwise treated as "affected taxpayers" by the IRS News Release or other guidance or section 301.7508A–1(d)(1) are not eligible for relief under section 7508A, except for the relief for section 1031 like-kind exchanges.

.02 In order to avoid unnecessary duplication, the following tables do not include acts specified in sections 7508 or 7508A or the regulations thereunder. Thus, for example, no mention is made in the following tables of the filing of tax returns or the payment of taxes (or an installment thereof) because these acts are already covered by sections 7508 and 7508A and the regulations thereunder. Also, the following tables do not refer to the making of accounting method elections or any other elections required to be made on tax returns or attachments thereto. Reference to these elections is not necessary because

postponement of the filing of a tax return automatically postpones the making of any election required to be made on the return or an attachment thereto.

.03 The following tables refer only to postponement of acts performed by taxpayers. Additional guidance will be published in the Internal Revenue Bulletin if a decision is made that acts performed by the government may be postponed under section 7508A.

SECTION 5. ACCOUNTING METHODS AND PERIODS

	Statute or Regulation	Act Postponed
1.	Chapter 1, Subchapter E of the Code	Any act relating to the adoption, election, retention, or change of any accounting method or accounting period, or to the use of an accounting method or accounting period, that is required to be performed on or before the due date of a tax return (including extensions). Examples of such acts include (a) the requirements in Rev. Procs. 2002–37, 2002–1 C.B. 1030, 2002–38, 2002–1 C.B. 1037 and 2002–39, 2002–1 C.B. 1046, and 2003–62, 2003–2 C.B. 299, that Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, be filed with the Director, Internal Revenue Service Center, on or before the due date (or the due date including extensions) of the tax return for the short period required to effect the change in accounting period; and (b) the requirement in Rev. Proc. 2002–9, 2002–1 C.B. 327, section 6.02 (3) that a copy of Form 3115 must be filed with the national office no later than when the original Form 3115 is filed with the timely filed tax return for the year of the accounting method change.
2.	Treas. Reg. § 1.381(c)(4)–1(d)(2)	If the acquiring corporation is not permitted to use the method of accounting used by the acquiring corporation, the method of accounting used by the distributor/transferor corporation, or the principal method of accounting; or if the corporation wishes to use a new method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Section 1.381(c)(4)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 83–77, 1983–2 C.B. 594, provides an automatic 90-day extension.
3.	Treas. Reg. § 1.381(c)(5)–1(d)(2)	If the acquiring corporation is not permitted to use the inventory method used by the acquiring corporation, the inventory method used by the distributor/transferor corporation, or the principal method of accounting, or wishes to use a new method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Section 1.381(c)(5)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 83–77 provides an automatic 90-day extension.
4.	Treas. Reg. § 1.442–1(b)(1)	In order to secure prior approval of an adoption, change, or retention of a taxpayer's annual accounting period, the taxpayer generally must file an application on Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, with the Commissioner within such time as is provided in administrative procedures published by the Commissioner from time to time. *See*, for example, Rev. Procs. 2002–37, 2002–38, 2002–39 and 2003–62.
5.	Treas. Reg. § 1.444–3T(b)(1)	A section 444 election must be made by filing Form 8716, *Election to Have a Tax Year Other Than a Required Tax Year*, with the Service Center. Generally, Form 8716 must be filed by the earlier of (a) the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective, or (b) the due date (without regard to extensions) of the income tax return resulting from the section 444 election.
6.	Treas. Reg. § 1.446–1(e)(2)(i)	Section 6 of Rev. Proc. 2002–9, 2002–1 C.B. 327, 341, allows a taxpayer to change a method of accounting within the terms of the revenue procedure by attaching the application form to the timely filed return for the year of change. Section 6.02(3)(b) grants an automatic extension of 6 months within which to file an amended return with the application for the change following a timely filed original return for the year of change.

	Statute or Regulation	Act Postponed
7.	Treas. Reg. § 1.446–1(e)(3)(i)	To secure the Commissioner's consent to a change in method of accounting, the taxpayer must file an application on Form 3115, *Application for Change in Accounting Method*, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting (*i.e.*, must be filed by the last day of such taxable year). This filing requirement is also in Rev. Proc. 97–27, 1997–1 C.B. 680. (*But see* Rev. Proc. 2002–9 for automatic changes in method of accounting that can be made with the return.)
8.	Sec. 451(e)	Section 451(e) permits a taxpayer using the cash receipts and disbursements method of accounting who derives income from the sale or exchange of livestock in excess of the number he would sell if he followed his usual business practices to elect (which election is deemed valid if made within the period described in section 1033(e)(2)) to include such income for the taxable year following the taxable year of such sale or exchange if, under his usual business practices, the sale or exchange would not have occurred if it were not for drought, flood, or other weather-related conditions and that such conditions resulted in the area being designated as eligible for Federal assistance.
9.	Treas. Reg. § 1.461–1(c)(3)(ii)	A taxpayer may elect, with the consent of the Commissioner, to accrue real property taxes ratably in accordance with section 461(c). A written request for permission to make such an election must be submitted within 90 days after the beginning of the taxable year to which the election is first applicable. Rev. Proc. 83–77 provides an automatic 90-day extension.
10.	Treas. Reg. § 1.7519–2T(a)(2), (3) and (4)	A partnership or S corporation must file the Form 8752, *Required Payment or Refund Under Section 7519*, if the taxpayer has made an election under section 444 to use a taxable year other than its required taxable year and the election is still in effect. The Form 8752 must be filed and any required payment must be made by the date stated in the instructions to Form 8752.
11.	Rev. Proc. 92–29, Section 6.02	A developer of real estate requesting the Commissioner's consent to use the alternative cost method must file a private letter ruling request within 30 days after the close of the taxable year in which the first benefited property in the project is sold. The request must include a consent extending the period of limitation on the assessment of income tax with respect to the use of the alternative cost method.

SECTION 6. BUSINESS AND INDIVIDUAL TAX ISSUES

	Statute or Regulation	Act Postponed
1.	Treas. Reg. § 1.71–1T(b), Q&A–7	A payer spouse may send cash to a third party on behalf of a spouse that qualifies for alimony or separate maintenance payments if the payments are made to the third party at the written request or consent of the payee spouse. The request or consent must state that the parties intend the payment to be treated as an alimony payment to the payee spouse subject to the rules of section 71. The payer spouse must receive the request or consent prior to the date of filing of the payer spouse's first return of tax for the taxable year in which the payment was made.
2.	Treas. Reg. § 1.77–1	A taxpayer who receives a loan from the Commodity Credit Corporation may elect to include the amount of the loan in his gross income for the taxable year in which the loan is received. The taxpayer in subsequent taxable years must include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Section 1.77–1 requires such requests to be filed within 90 days after the beginning of the taxable year of change. Rev. Proc. 83–77 provides an automatic 90-day extension.

	Statute or Regulation	Act Postponed
3.	Treas. Reg. § 1.110–1(b)(4)(ii)(A)	The lessee must expend its construction allowance on the qualified long-term real property within eight and one-half months after the close of the taxable year in which the construction allowance was received.
4.	Sec. 118(c)(2)	A contribution in aid of construction received by a regulated public utility that provides water or sewerage disposal services must be expended by the utility on qualifying property before the end of the second taxable year after the year in which it was received by the utility.
5.	Treas. Reg. § 1.170A–5(a)(2)	A contribution of an undivided present interest in tangible personal property shall be treated as made upon receipt by the donee of a formally executed and acknowledged deed of gift. The period of initial possession by the donee may not be deferred for more than one year.
6.	Sec. 172(b)(3)	A taxpayer entitled to a carryback period under section 172(b)(1) may elect to relinquish the entire carryback period. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss for which the election is to be effective.
7.	Sec. 172(f)(6)	A taxpayer entitled to a 10-year carryback under section 172(b)(1)(C) (relating to certain specified liability losses) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to that section. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss.
8.	Sec. 172(i)(3)	A taxpayer entitled to a 5-year carryback period under section 172(b)(1)(G) (relating to certain farming losses) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to that section. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss.
9.	Sec. 468A(g)	A taxpayer that makes payments to a nuclear decommissioning fund with respect to a taxable year must make the payments within 2½-months after the close of such taxable year (the deemed payment date).
10.	Treas. Reg. § 1.468A–3(h)(1)(v)	A taxpayer must file a request for a schedule of ruling amounts for a nuclear decommissioning fund by the deemed payment date (2½-months after the close of the taxable year for which the schedule of ruling amounts is sought).
11.	Treas. Reg. § 1.468A–3(h)(1)(vii)	A taxpayer has 30 days to provide additional requested information with respect to a request for a schedule of ruling amounts. If the information is not provided within the 30 days, the request will not be considered filed until the date the information is provided.
12.	Sec. 530(h)	A trustee of a Coverdell education savings account must provide certain information concerning the account to the beneficiary by January 31 following the calendar year to which the information relates. In addition, Form 5498, *Individual Retirement Arrangement Contribution Information*, must be filed with the IRS by May 31 following the calendar year to which the information relates.
13.	Sec. 563(a)	In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.

	Statute or Regulation	Act Postponed
14.	Sec. 563(b)	In the determination of the dividends paid deduction for purposes of the personal holding company tax imposed by section 541, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the taxpayer elects on its return for the taxable year, be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.
15.	Sec. 563(c)	In the determination of the dividends paid deduction for purposes of part III, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the company designates such dividend as being taken into account, be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.
16.	Sec. 563(d)	For the purpose of applying section 562(a), with respect to distributions under subsection (a), (b), or (c) of section 562, a distribution made after the close of the taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.
17.	Sec. 529 (c)(3)(C)(i)	A rollover contribution to another qualified tuition program must be made no later than the 60th day after the date of a distribution from a qualified tuition program.
18.	Sec. 530(d)(4)(C)(i)	Excess contributions to a Coverdell education savings account must be distributed before a specified time in the taxable year following the taxable year in which the contribution is made.
19.	Sec. 530(d)(5)	A rollover contribution to another Coverdell education savings account must be made no later than the 60th day after the date of a payment or distribution from a Coverdell education savings account.
20.	Sec. 1031(a)(3)	In a deferred exchange, property otherwise qualified as like-kind property under section 1031 is treated as like-kind property if the 45-day identification period and the 180-day exchange period requirements under section 1031(a)(3) and section 1.1031(k)–1(b)(2) are met. *See also* section 17 of this revenue procedure.
21.	Sec. 1031	Property held in a qualified exchange accommodation arrangement may qualify as "replacement property" or "relinquished property" under section 1031 if the requirements of section 4 of Rev. Proc. 2000–37, 2000–2 C.B. 308, modified by Rev. Proc. 2004–51, 2004–33 I.R.B. 294, are met, including the 5-business day period to enter into a qualified exchange accommodation agreement (QEAA), the 45-day identification period, the 180-day exchange period, and the 180-day combined time period. *See also* section 17 of this revenue procedure.
22.	Sec. 1033	An election respecting the nonrecognition of gain on the involuntary conversion of property (section 1.1033(a)–2(c)(1) and (2)) is required to be made within the time periods specified in section 1.1033(a)–2(c)(3), section 1.1033(g)–1(c), section 1033(e)(2)(A), or section 1033(h)(1)(B), as applicable.
23.	Sec. 1043(a)	If an eligible person (as defined under section 1043(b)) sells any property pursuant to a certificate of divestiture, then at the election of the taxpayer, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds the cost of any permitted property purchased by the taxpayer during the 60-day period beginning on the date of such sale.

	Statute or Regulation	Act Postponed
24.	Sec. 1045(a)	A taxpayer other than a corporation may elect to roll over gain from the sale of qualified small business stock held for more than six months if other qualified small business stock is purchased by the taxpayer during the 60-day period beginning on the date of sale.
25.	Sec. 1382(d)	An organization, to which section 1382(d) applies, is required to pay a patronage dividend within 8½-months after the close of the year.
26.	Sec. 1388(j)(3)(A)	Any cooperative organization that exercises its option to net patronage gains and losses, is required to give notice to its patrons of the netting by the 15th day of the 9th month following the close of the taxable year.
27.	Treas. Reg. § 301.7701–3(c)	The effective date of an entity classification election (Form 8832, *Entity Classification Election*) cannot be more than 75 days prior to the date on which the election is filed.
28.	Treas. Reg. § 301.9100–2(a)(1)	An automatic extension of 12 months from the due date for making a regulatory election is granted to make certain elections, including the election to use other than the required taxable year under section 444, and the election to use LIFO under section 472.
29.	Treas. Reg. §§ 301.9100–2(b)–(d)	An automatic extension of 6 months from the due date of a return, excluding extensions, is granted to make the regulatory or statutory elections whose due dates are the due date of the return or the due date of the return including extensions (for example, a taxpayer has an automatic 6 month extension to file an application to change a method of accounting under Rev. Proc. 2002–9), provided the taxpayer (a) timely filed its return for the year of election, (b) within that 6-month extension period, takes the required corrective action to file the election in accordance with the statute, regulations, revenue procedure, revenue ruling, notice or announcement permitting the election, and (c) writes at the top of the return, statement of election or other form "FILED PURSUANT TO section 301.9100–2."

SECTION 7. CORPORATE ISSUES

	Statute or Regulation	Act Postponed
1.	Sec. 302(e)(1)	A corporation must complete a distribution in pursuance of a plan of partial liquidation of a corporation within the specified period.
2.	Sec. 303 and Treas. Reg. § 1.303–2	A corporation must complete the distribution of property to a shareholder in redemption of all or part of the stock of the corporation which (for Federal estate tax purposes) is included in determining the estate of a decedent. Section 303 and section 1.303–2 require, among other things, that the distribution occur within the specified period.
3.	Sec. 304(b)(3)(C)	If certain requirements are met, section 304(a) does not apply to a transaction involving the formation of a bank holding company. One requirement is that within a specified period (generally 2 years) after control of a bank is acquired, stock constituting control of the bank is transferred to a bank holding company in connection with the bank holding company's formation.
4.	Sec. 316(b)(2)(A) and (B)(ii) and Treas. Reg. § 1.316–1(b)(2) and (5)	A personal holding company may designate as a dividend to a shareholder all or part of a distribution in complete liquidation described in section 316(b)(2)(B) and section 1.316–1(b) by, *inter alia*, including such amount as a dividend in Form 1099–DIV, *Dividends and Distributions*, filed in respect of such shareholder pursuant to section 6042(a) and the regulations thereunder and in a written statement of dividend payments furnished to such shareholder pursuant to section 6042(c) and section 1.6042–4.

	Statute or Regulation	Act Postponed
5.	Sec. 332(b) and Treas. Reg. §§ 1.332–3 and 1.332–4	A corporation must completely liquidate a corporate subsidiary within the specified period.
6.	Sec. 338(d)(3) and (h), and Treas. Reg. § 1.338–2	An acquiring corporation must complete a "qualified stock purchase" of a target corporation's stock within the specified acquisition period.
7.	Sec. 338(g) and Treas. Reg. § 1.338–2	An acquiring corporation may elect to treat certain stock purchases as asset acquisitions. The election must be made within the specified period.
8.	Sec. 338(h)(10) and Treas. Reg. § 1.338(h)(10)–1(c)	An acquiring corporation and selling group of corporations may elect to treat certain stock purchases as asset purchases, and to avoid gain or loss upon the stock sale. The election must be made within the specified period.
9.	Treas. Reg. § 1.381(c)(17)–1(c)	An acquiring corporation files a Form 976, *Claim for Deficiency Dividends Deductions by a Personal Holding Company, Regulated Investment Company, or Real Estate Investment Trust*, within 120 days after the date of the determination under section 547(c) to claim a deduction of a deficiency dividend.
10.	Treas. Reg. § 1.441–3(b)	A personal service corporation may obtain the approval of the Commissioner to adopt, change, or retain an annual accounting period by filing From 1128, *Application to Adopt, Change, or Retain a Tax Year*, within such time as is provided in the administrative procedures published by the Commissioner. *See* Rev. Procs. 2002–38, 2002–1 C.B. 1037, and 2002–39.
11.	Sec. 562(b)(1)(B)	In the case of a complete liquidation (except in the case of a complete liquidation of a personal holding company or foreign personal holding company) occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.
12.	Sec. 562(b)(2)	In the case of a complete liquidation of a personal holding company occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction to the extent that such is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution.
13.	Sec. 597 and Treas. Reg. § 1.597–4(g)	A consolidated group of which an Institution (as defined by section 1.591–1(b)) is a subsidiary may elect irrevocably not to include the Institution in its affiliated group if the Institution is placed in Agency (as defined by section 1.591–1(b)) receivership (whether or not assets or deposit liabilities of the Institution are transferred to a Bridge Bank (as defined by section 1.591–1(b)). Except as otherwise provided in section 1.597–4(g)(6), a consolidated group makes the election by sending a written statement by certified mail to the affected Institution on or before the later of 120 days after its placement in Agency (as defined by section 1.591–1(b)) receivership or May 31, 1996.
14.	Sec. 1502 and Treas. Reg. § 1.1502–75(c)(1)(i)	A common parent must apply for permission to discontinue filing consolidated returns within a specified period after the date of enactment of a law affecting the computation of tax liability.

	Statute or Regulation	Act Postponed
15.	Sec. 6425 and Treas. Reg. § 1.6425–1	Corporations applying for an adjustment of an overpayment of estimated income tax must file Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, on or before the 15th day of the third month after the taxable year, or before the date the corporation first files its income tax return for such year, whichever is earlier.
16.	Rev. Proc. 2003–33, Section 5	If the filer complies with the procedures set forth in the revenue procedure, including a requirement that the filer file Form 8023, *Elections Under Section 338 for Corporations Making Qualified Stock Purchases*, within the specified period, the filer gets an automatic extension under section 301.9100–3 to file an election under section 338.

SECTION 8. EMPLOYEE BENEFIT ISSUES

	Statute or Regulation	Act Postponed
1.	Sec. 72(p)(2)(B) and (C), and Treas. Reg. § 1.72(p)–1, Q&A–10	A loan from a qualified employer plan to a participant in, or a beneficiary of, such plan must be repaid according to certain time schedules specified in section 72(p)(2)(B) and (C) (including, if applicable, any grace period granted pursuant to section 1.72(p)–1, Q&A–10).
2.	Sec. 72(t)(2)(A)(iv)	Under section 72(t)(2)(A)(iv), to avoid the imposition of a 10-percent additional tax on a distribution from a qualified retirement plan, the distribution must be part of a series of substantially equal periodic payments, made at least annually.
3.	Sec. 72(t)(2)(F)	To avoid the imposition of a 10-percent additional tax on a distribution from an individual retirement arrangement (IRA) for a first-time home purchase, such distribution must be used within 120 days of the distribution to pay qualified acquisition costs or rolled into an IRA.
4.	Sec. 83(b) and Treas. Reg. § 1.83–2(b)	If substantially nonvested property to which section 83 applies is transferred to any person, the service provider may elect to include the excess of the fair market value of the property over the amount paid (if any) for the property in gross income for the taxable year in which such property is transferred. This election must occur not later than 30 days after the date the property was transferred.
5.	Proposed Treas. Reg. § 1.125–1, Q&A–15	Cafeteria plan participants will avoid constructive receipt of the taxable amounts if they elect the benefits they will receive before the beginning of the period during which the benefits will be provided.
6.	Proposed Treas. Reg. § 1.125–1, Q&A–14 and Proposed Treas. Reg. § 1.125–2, Q&A–7	Cafeteria plan participants will not be in constructive receipt if, at the end of the plan year, they forfeit amounts elected but not used during the plan year.
7.	Proposed Treas. Reg. § 1.125–2, Q&A–5	Cafeteria plan participants may receive in cash the value of unused vacation days on or before the earlier of the last day of the cafeteria plan year or the last day of the employee's taxable year to which the unused days relate.
8.	Treas. Reg. § 1.162–27(e)(2)	A performance goal is considered preestablished if it is established in writing by the corporation's compensation committee not later than 90 days after the commencement of the period of service to which the performance goal relates if the outcome is substantially uncertain at the time the compensation committee actually establishes the goal. In no event, however, will the performance goal be considered pre-established if it is established after 25 percent of the period of service has elapsed.

	Statute or Regulation	Act Postponed
9.	Sec. 220(f)(5)	A rollover contribution to an Archer MSA must be made no later than the 60th day after the day on which the holder receives a payment or distribution from an Archer MSA.
10.	Sec. 220(h)	A trustee or custodian of an MSA (Archer MSA or Medicare+Choice MSA) must provide certain information concerning the MSA to the account holder by January 31 following the calendar year to which the information relates. In addition, MSA contribution information must be furnished to the account holder, and Form 5498 filed with the IRS, by May 31 following the calendar year to which the information relates.
11.	Secs. 401(a)(9), 403(a)(1), 403(b)(10), 408(a)(6), 408(b)(3) and 457(d)(2)	The first required minimum distribution from plans subject to the rules in section 401(a)(9) must be made no later than the required beginning date. Subsequent required minimum distributions must be made by the end of each distribution calendar year.
12.	Sec. 401(a)(28)(B)(i)	A qualified participant in an ESOP (as defined in section 401(a)(28)(B)(iii)) may elect within 90 days after the close of each plan year in the qualified election period (as defined in section 401(a)(28)(B)(iv)) to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (50 percent in the case of the last election).
13.	Sec. 401(a)(28)(B)(ii)	A plan must distribute the portion of the participant's account covered by an election under section 401(a)(28)(B)(i) within 90 days after the period during which an election can be made; or the plan must offer at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making the election under section 401(a)(28)(B)(i) and within 90 days after the period during which the election may be made, the plan must invest the portion of the participant's account in accordance with the participant's election.
14.	Sec. 401(a)(30) and Treas. Reg. § 1.401(a)–30 and § 1.402(g)–1	Excess deferrals for a calendar year, plus income attributable to the excess, must be distributed no later than the first April 15 following the calendar year.
15.	Sec. 401(b) and Treas. Reg. § 1.401(b)–1	A retirement plan that fails to satisfy the requirements of section 401(a) or section 403(a) on any day because of a disqualifying provision will be treated as satisfying such requirements on such day if, prior to the expiration of the applicable remedial amendment period, all plan provisions necessary to satisfy the requirements of section 401(a) or 403(a) are in effect and have been made effective for the whole of such period.
16.	Sec. 401(k)(8)	A cash or deferred arrangement must distribute excess contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the arrangement no later than the close of the following plan year.
17.	Sec. 401(m)(6)	A plan subject to section 401(m) must distribute excess aggregate contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the plan no later than the close of the following plan year.
18.	Sec. 402(g)(2)(A) and Treas. Reg. § 1.402(g)–1	An individual with excess deferrals for a taxable year must notify a plan, not later than a specified date following the taxable year that excess deferrals have been contributed to that plan for the taxable year. A distribution of excess deferrals identified by the individual, plus income attributable to the excess, must be accomplished no later than the first April 15 following the taxable year of the excess.
19.	Sec. 404(k)(2)(A)(ii)	An ESOP receiving dividends on stock of the C corporation maintaining the plan must distribute the dividend in cash to participants or beneficiaries not later than 90 days after the close of the plan year in which the dividend was paid.

	Statute or Regulation	Act Postponed
20.	Secs. 408(i) and 6047(c)	A trustee or issuer of an individual retirement arrangement (IRA) must provide certain information concerning the IRA to the IRA owner by January 31 following the calendar year to which the information relates. In addition, IRA contribution information must be furnished to the owner, and Form 5498 filed with the IRS, by May 31 following the calendar year to which the information relates.
21.	Sec. 409(h)(4)	An employer required to repurchase employer securities under section 409(h)(1)(B) must provide a put option for a period of at least 60 days following the date of distribution of employer securities to a participant, and if the put option is not exercised, for an additional 60-day period in the following plan year. A participant who receives a distribution of employer securities under section 409(h)(1)(B) must exercise the put option provided by that section within a period of at least 60 days following the date of distribution, or if the put option is not exercised within that period, for an additional 60-day period in the following plan year.
22.	Sec. 409(h)(5)	An employer required to repurchase employer securities distributed as part of a total distribution must pay for the securities in substantially equal periodic payments (at least annually) over a period beginning not later than 30 days after the exercise of the put option and not exceeding 5 years.
23.	Sec. 409(h)(6)	An employer required to repurchase employer securities distributed as part of an installment distribution must pay for the securities not later than 30 days after the exercise of the put option under section 409(h)(4).
24.	Sec. 409(o)	An ESOP must commence the distribution of a participant's account balance, if the participant elects, not later than 1 year after the close of the plan year — i) in which the participant separates from service by reason of attaining normal retirement age under the plan, death or disability; or ii) which is the 5th plan year following the plan year in which the participant otherwise separates from service (except if the participant is reemployed before distribution is required to begin).
25.	Sec. 457(e)(16)(B)	An eligible rollover distribution from a section 457 eligible governmental plan may be rolled over to an eligible retirement plan no later than the 60th day following the day the distributee received the distributed property.
26.	Sec. 1042(a)(2)	A taxpayer must purchase qualified replacement property (defined in section 1042(c)(4)) within the replacement period, defined in section 1042(c)(3) as the period which begins 3 months before the date of the sale of qualified securities to an ESOP and ends 12 months after the date of such sale.
27.	Sec. 4972(c)(3)	Nondeductible plan contributions must be distributed prior to a certain date to avoid a 10 percent tax.
28.	Sec. 4979 and Treas. Reg. § 54.4979–1	A 10 percent tax on the amount of excess contributions and excess aggregate contributions under a plan for a plan year will be imposed unless the excess, plus income attributable to the excess is distributed (or, if forfeitable, forfeited) no later than 2$^1/_2$-months after the close of the plan year. In the case of an employer maintaining a SARSEP, employees must be notified of the excess by the employer within the 2$^1/_2$-month period to avoid the tax.

	Statute or Regulation	Act Postponed
29.	Secs. 6033, 6039D, 6047, 6057, 6058, and 6059	Form 5500, *Annual Return/Report of Employee Benefit Plan*, and Form 5500–EZ, *Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan*, which are used to report annual information concerning employee benefit plans and fringe benefit plans, must be filed by a specified time. *General Advice* Affected filers are advised to follow the instructions accompanying the Form 5500 series (or other guidance published on the postponement) regarding how to file the forms when postponements are granted pursuant to section 7508 or section 7508A. *Combat Zone Postponements under Section 7508* Individual taxpayers who meet the requirements of section 7508 are entitled to a postponement of time to file the Form 5500 or Form 5500–EZ under section 7508. The postponement of the Form 5500 series filing due date under section 7508 will also be permitted by the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC) for similarly situated individuals who are plan administrators. *Postponements for Presidentially Declared Disasters and Terroristic or Military Actions under Section 7508A* In the case of "affected taxpayers," as defined in section 301.7508A–1(d), the IRS may permit a postponement of the filing of the Form 5500 or Form 5500–EZ. Taxpayers who are unable to obtain on a timely basis information necessary for completing the forms from a bank, insurance company, or any other service provider because such service providers' operations are located in a covered disaster area will be treated as "affected taxpayers." Whatever postponement of the Form 5500 series filing due date is permitted by the IRS under section 7508A will also be permitted by the Department of Labor and PBGC for similarly situated plan administrators and direct filing entities.
30.	Rev. Proc. 2003–44, Sections 9.02(1) and (2)	The correction period for self-correction of operational failures is the last day of the second plan year following the plan year for which the failure occurred. The correction period for self-correction of operational failures for transferred assets does not end until the last day of the first plan year that begins after the corporate merger, acquisition, or other similar employer transaction.
31.	Rev. Proc. 2003–44, Section 12.07	If the submission involves a plan with transferred assets and no new incidents of the failures in the submission occurred after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the plan sponsor may calculate the amount of plan assets and number of plan participants based on the Form 5500 information that would have been filed by the plan sponsor for the plan year that includes the employer transaction if the transferred assets were maintained as a separate plan.
32.	Rev. Proc. 2003–44, Section 14.03	If an examination involves a plan with transferred assets and the IRS determines that no new incidents of the failures that relate to the transferred assets occurred after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the sanction under Audit CAP will not exceed the sanction that would apply if the transferred assets were maintained as a separate plan.

	Statute or Regulation	Act Postponed
1.	Sec. 643(g)	The trustee may elect to treat certain payments of estimated tax as paid by the beneficiary. The election shall be made on or before the 65th day after the close of the taxable year of the trust.
2.	Sec. 645 and Treas. Reg. § 1.645–1(c)	An election to treat a qualified revocable trust as part of the decedent's estate must be made by filing Form 8855, *Election To Treat a Qualified Revocable Trust as Part of an Estate*, by the due date (including extensions) of the estate's Federal income tax return for the estate's first taxable year, if there is an executor, or by the due date (including extensions) of the trust's Federal income tax return for the trust's first taxable year (treating the trust as an estate), if there is no executor.
3.	Sec. 2011(c)	The executor of a decedent's estate must file a claim for a credit for state estate, inheritance, legacy or succession taxes by filing a claim within 4 years of filing Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*. (Section 2011 does not apply to estates of decedents dying after December 31, 2004; *see* section 2058).
4.	Sec. 2014(e)	The executor of a decedent's estate must file a claim for foreign death taxes within 4 years of filing Form 706.
5.	Sec. 2016 and Treas. Reg. § 20.2016–1	If an executor of a decedent's estate (or any other person) receives a refund of any state or foreign death taxes claimed as a credit on Form 706, the IRS must be notified within 30 days of receipt. (Section 2016 is amended effective for estates of decedents dying after December 31, 2004; *see* section 2058).
6.	Sec. 2031(c)	If an executor of a decedent's estate elects on Form 706 to exclude a portion of the value of land that is subject to a qualified conservation easement, agreements relating to development rights must be implemented within 2 years after the date of the decedent's death.
7.	Sec. 2032(d)	The executor of a decedent's estate may elect an alternate valuation on a late filed Form 706 if the Form 706 is not filed later than 1 year after the due date.
8.	Sec. 2032A(c)(7)	A qualified heir, with respect to specially valued property, is provided a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax.
9.	Sec. 2032A(d)(3)	The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property.
10.	Sec. 2046	A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21.
11.	Sec. 2053(d) and Treas. Reg. §§ 20.2053–9(c) and 10(c)	If the executor of a decedent's estate elects to take a deduction for state and foreign death tax imposed upon a transfer for charitable or other uses, the executor must file a written notification to that effect with the IRS before expiration of the period of limitations on assessments (generally 3 years). (Section 2053 is amended effective for estates of decedents dying after December 31, 2004, to apply only with respect to foreign death taxes).
12.	Sec. 2055(e)(3)	A party in interest must commence a judicial proceeding to change an interest into a qualified interest no later than the 90th day after the estate tax return (Form 706) is required to be filed or, if no return is required, the last date for filing the income tax return for the first taxable year of the trust.

	Statute or Regulation	Act Postponed
13.	Sec. 2056(d)	A qualified domestic trust (QDOT) election must be made on Form 706, Schedule M, and the property must be transferred to the trust before the date on which the return is made. Any reformation to determine if a trust is a QDOT requires that the judicial proceeding be commenced on or before the due date for filing the return.
14.	Sec. 2056A(b)(2)	The trustee of a QDOT must file a claim for refund of excess tax no later than 1 year after the date of final determination of the decedent's estate tax liability.
15.	Sec. 2057(i)(3)(G)	A qualified heir, with respect to qualified family owned business, has a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax. (The section 2057 election is not available to estates of decedents dying after December 31, 2004).
16.	Sec. 2057(i)(3)(H)	The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property.
17.	Sec. 2058(d)	The executor of a decedent's estate may deduct estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia from the decedent's gross estate. With certain exceptions, the deduction is only allowed provided the taxes are actually paid and the deduction claimed within 4 years of filing Form 706.
18.	Sec. 2516	The IRS will treat certain transfers as made for full and adequate consideration in money or money's worth where husband and wife enter into a written agreement relative to their marital and property rights and divorce actually occurs within the 3-year period beginning on the date 1 year before such agreement is entered into.
19.	Sec. 2518(b)	A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21.

SECTION 10. EXEMPT ORGANIZATION ISSUES

	Statute or Regulation	Act Postponed
1.	Sec. 501(h)	Under section 501(h), certain eligible 501(c)(3) organizations may elect on Form 5768, *Election/Revocation of Election by an Eligible Sec. 501(c)(3) Organization to Make Expenditures to Influence Legislation*, to have their legislative activities measured solely by expenditures. Form 5768 is effective beginning with a taxable period, provided it is filed before the end of the organization's taxable period.
2.	Sec. 505(c)(1)	An organization must give notice by filing Form 1024, *Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120*, to be recognized as an organization exempt under section 501(c)(9) or section 501(c)(17). Generally, if the exemption is to apply for any period before the giving of the notice, section 505(c)–1T, Q&A–6, of the regulations requires that Form 1024 be filed within 15 months from the end of the month in which the organization was organized.
3.	Sec. 508 and Treas. Reg. § 1.508–1	A purported section 501(c)(3) organization must generally file Form 1023, *Application for Recognition of Exemption*, to qualify for exemption. Generally, if the exemption is to apply for any period before the giving of the notice, the Form 1023 must be filed within 15 months from the end of the month in which the organization was organized.

	Statute or Regulation	Act Postponed
4.	Sec. 527(i)(2)	Certain political organizations shall not be treated as tax-exempt section 527 organizations unless each such organization electronically files a notice (Form 8871, *Political Organization Notice of Section 527 Status)* not less than 24 hours after the date on which the organization is established, or, in the case of a material change in the information required, not later than 30 days after such material change.
5.	Sec. 527(j)(2)	Under section 527(j)(2), certain tax-exempt political organizations that accept contributions or make expenditures for an exempt function under section 527 during a calendar year are required to file periodic reports on Form 8872, *Political Organization Report of Contributions and Expenditures*, beginning with the first month or quarter in which they accept contributions or make expenditures, unless excepted. In addition, tax-exempt political organizations that make contributions or expenditures with respect to an election for federal office may be required to file pre-election reports for that election. A tax-exempt political organization that does not file the required Form 8872, or that fails to include the required information, must pay an amount calculated by multiplying the amount of the contributions or expenditures that are not disclosed by the highest corporate tax rate.
6.	Sec. 6033(g)(1) and Treas. Reg. § 1.6033–2(e)	Annual information returns, Forms 990, *Return of Organization Exempt From Income Tax*, of certain tax-exempt political organizations described under section 527 must be filed on or before the 15th day of the 5th month following the close of the taxable year.
7.	Sec. 6072(e) and Treas. Reg. § 1. 6033–2(e)	Annual returns of organizations exempt under section 501(a) must be filed on or before the 15th day of the 5th month following the close of the taxable year.
8.	Rev. Proc. 80–27, Section 6.01	The central organization of a group ruling is required to report information regarding the status of members of the group annually (at least 90 days before the close of its annual accounting period).

SECTION 11. EXCISE TAX ISSUES

	Statute or Regulation	Act Postponed
1.	Treas. Reg. § 48.4101–1(h)(v)	A registrant must notify the IRS of any change in the information a registrant has submitted within 10 days.
2.	Sec. 4221(b) and Treas. Reg. § 48.4221–2(c)	A manufacturer is allowed to make a tax-free sale of articles for resale to a second purchaser for use in further manufacture. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.
3.	Sec. 4221(b) and Treas. Reg. § 48.4221–3(c)	A manufacturer is allowed to make a tax-free sale of articles for export. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.
4.	Sec. 4221(e)(2)(A) and Treas. Reg. § 48.4221–7(c)	A manufacturer is allowed to make a tax-free sale of tires for use by the purchaser in connection with the sale of another article manufactured or produced by the purchaser. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.

SECTION 12. INTERNATIONAL ISSUES

	Statute or Regulation	Act Postponed
1.	Sec. 482 and Treas. Reg. § 1.482–1(g)(4)(ii)(C)	A claim for a setoff of a section 482 allocation by the IRS must be filed within 30 days of either the date of the IRS's letter transmitting an examination report with notice of the proposed adjustment or the date of a notice of deficiency.

	Statute or Regulation	Act Postponed
2.	Sec. 482 and Treas. Reg. § 1.482–1(j)(2)	A claim for retroactive application of the final section 482 regulations, otherwise effective only for taxable years beginning after October 6, 1994, must be filed prior to the expiration of the statute of limitations for the year for which retroactive application is sought.
3.	Sec. 482 and Treas. Reg. § 1.482–7(j)(2)	A participant in a cost-sharing arrangement must provide documentation regarding the arrangement, as well as documentation specified in sections 1.482–7(b)(4) and 1.482–7(c)(1), within 30 days of a request by the IRS.
4.	Treas. Reg. § 1.882–5(d)(2)(ii)(A)(2)	Liabilities of a foreign corporation that is not a bank must be entered on a set of books at a time reasonably contemporaneous with the time the liabilities are incurred.
5.	Treas. Reg. § 1.882–5(d)(2)(iii)(A)(1)	Liabilities of foreign corporations that are engaged in a banking business must be entered on a set of books relating to an activity that produces ECI before the close of the day on which the liability is incurred.
6.	Treas. Reg. § 1.884–2T(b)(3)(i)	Requirement that marketable securities be identified on the books of a U.S. trade or business within 30 days of the date an equivalent amount of U.S. assets ceases to be U.S. assets. This requirement applies when a taxpayer has elected to be treated as remaining engaged in a U.S. trade or business for branch profits tax purposes.
7.	Treas. Reg. § 1.884–4(b)(3)(ii)(B)	Requirement that a foreign corporation which identifies liabilities as giving rise to U.S. branch interest, send a statement to the recipients of such interest within two months of the end of the calendar year in which the interest was paid, stating that such interest was U.S. source income (if the corporation did not make a return pursuant to section 6049 with respect to the interest payment).
8.	Sec. 922(a)(1)(E) and Treas. Reg. § 1.922–1(j) (Q&A–19)	The FSC must appoint a new non-U.S. resident director within 30 days of the date of death, resignation, or removal of the former director, in the event that the sole non-U.S. resident director of a FSC dies, resigns, or is removed.
9.	Sec. 924(b)(2)(B) and Treas. Reg. § 1.924(a)–1T(j)(2)(i)	A taxpayer must execute an agreement regarding unequal apportionment at a time when at least 12 months remain in the period of limitations (including extensions) for assessment of tax with respect to each shareholder of the small FSC in order to apportion unequally among shareholders of a small FSC the $5 million foreign trading gross receipts used to determine exempt foreign trade income.
10.	Sec. 924(c)(2) and Treas. Reg. § 1.924(c)–1(c)(4)	The FSC must open a new qualifying foreign bank account within 30 days of the date of termination of the original bank account, if a FSC's qualifying foreign bank account terminates during the taxable year due to circumstances beyond the control of the FSC.
11.	Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(1)	The FSC must transfer funds from its foreign bank account to its U.S. bank account, equal to the dividends, salaries, or fees disbursed, and such transfer must take place within 12 months of the date of the original disbursement from the U.S. bank account, if dividends, salaries, or fees are disbursed from a FSC's U.S. bank account.
12.	Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(2)	The FSC must reimburse from its own bank account any dividends or other expenses that are paid by a related person, on or before the due date (including extensions) of the FSC's tax return for the taxable year to which the reimbursement relates.
13.	Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(3)	If the Commissioner determines that the taxpayer acted in good faith, the taxpayer may comply with the reimbursement requirement by reimbursing the funds within 90 days of the date of the Commissioner's determination, notwithstanding a taxpayer's failure to meet the return-filing-date reimbursement deadline in section 1.924(c)–1(d)(2).
14.	Sec. 924(e)(4) and Treas. Reg. § 1.924(e)–1(d)(2)(iii)	If a payment with respect to a transaction is made directly to the FSC or the related supplier in the United States, the funds must be transferred to and received by the FSC bank account outside the United States no later than 35 days after the receipt of good funds (*i.e.*, date of check clearance) on the transaction.

	Statute or Regulation	Act Postponed
15.	Temp. Treas. Reg. § 1.925(a)–1T(e)(4)	A FSC and its related supplier may redetermine a transfer pricing method, the amount of foreign trading gross receipts, and costs and expenses, provided such redetermination occurs before the expiration of the statute of limitations for claims for refund for both the FSC and related supplier, and provided the statute of limitations for assessment applicable to the party that has a deficiency in tax on account of the redetermination is open. *See* Treas. Reg. § 1.925(a)–1(c)(8)(i) for time limitations with respect to FSC administrative pricing grouping redeterminations and for a cross-reference to section 1.925(a)–1T(e)(4).
16.	Sec. 927(f)(3)(A) and Treas. Reg. § 1.927(f)–1(b) (Q&A–12)	A corporation may terminate its election to be treated as a FSC or a small FSC by revoking the election during the first 90 days of the FSC taxable year (other than the first year in which the election is effective) in which the revocation was to take effect.
17.	Sec. 927 and Temp. Treas. Reg. § 1.927(a)–1T (d)(2)(i)(B)	A taxpayer may satisfy the destination test with respect to property sold or leased by a seller or lessor if such property is delivered by the seller or lessor (or an agent of the seller or lessor) within the United States to a purchaser or lessee, if the property is ultimately delivered outside the United States (including delivery to a carrier or freight forwarder for delivery outside the United States) by the purchaser or lessee (or a subsequent purchaser or sublessee) within one year after the sale or lease.
18.	Sec. 927 and Temp. Treas. Reg. § 1.927(b)–1T(e)(2)(i)	A taxpayer that claims FSC commission deductions must designate the sales, leases, or rentals subject to the FSC commission agreement no later than the due date (as extended) of the tax return of the FSC for the taxable year in which the transaction(s) occurred.
19.	Sec. 927 and Treas. Reg. § 1.927(f)–1(a) (Q&A 4)	A transferee or other recipient of shares in the corporation (other than a shareholder that previously consented to the election) must consent to be bound by the prior election within 90 days of the first day of the FSC's taxable year to preserve the status of a corporation that previously qualified as a FSC or as a small FSC.
20.	Sec. 936 and Treas. Reg. § 1.936–11	A taxpayer that elects retroactive application of the regulation regarding separate lines of business for taxable years beginning after December 31, 1995, must elect to do so prior to the expiration of the statute of limitations for the year in question.
21.	Treas. Reg. §§ 1.964–1(c)(3)(ii) and –1T(g)(2)	An election of, or an adoption of or change in a method of accounting of a CFC (controlled foreign corporation) requires the filing of a written statement jointly executed by the controlling U.S. shareholders of the CFC within 180 days after the close of the taxable year of the CFC.
22.	Sec. 982(c)(2)(A)	Any person to whom a formal document request is mailed shall have the right to bring a proceeding to quash such request not later than the 90th day after the day such request was mailed.
23.	Treas. Reg. § 1.988–1(a)(7)(ii)	An election to have section 1.988–1(a)(2)(iii) apply to regulated futures contracts and nonequity options must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the taxpayer holds a contract described in section 988(c)(1)(D)(ii) and section 1.988–1(a)(7)(ii). A late election may be made within 30 days after the time prescribed for the election.
24.	Sec. 988(c)(1)(E)(iii)(V) (qualified fund) and Treas. Reg. § 1.988–1(a)(8)(i)(E)	A qualified fund election must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the partnership holds an instrument described in section 988(c)(1)(E)(i).
25.	Treas. Reg. § 1.988–3(b)	An election to treat (under certain circumstances) any gain or loss recognized on a contract described in section 1.988–2(d)(1) as capital gain or loss must be made by clearly identifying such transaction on taxpayer's books and records on the date the transaction is entered into.
26.	Treas. Reg. § 1.988–5(a)(8)(i)	Taxpayer must establish a record, and before the close of the date the hedge is entered into, the taxpayer must enter into the record for each qualified hedging transaction the information contained in sections 1.988–5(a)(8)(i)(A) through (E).

	Statute or Regulation	Act Postponed
27.	Treas. Reg. § 1.988–5(b)(3)(i)	Taxpayer must establish a record and before the close of the date the hedge is entered into, the taxpayer must enter into the record a clear description of the executory contract and the hedge.
28.	Treas. Reg. § 1.988–5(c)(2)	Taxpayer must identify a hedge and underlying stock or security under the rules of section 1.988–5(b)(3).
29.	Sec. 991	A corporation that elects IC-DISC treatment (other than in the corporation's first taxable year) must file Form 4876–A, *Election To Be Treated as an Interest Charge DISC*, with the regional service center during the 90-day period prior to the beginning of the tax year in which the election is to take effect.
30.	Sec. 991 and Treas. Reg. § 1.991–2(g)(2)	A corporation that filed a tax return as a DISC, but subsequently determines that it does not wish to be treated as a DISC, must notify the Commissioner more than 30 days before the expiration of period of limitations on assessment applicable to the tax year.
31.	Sec. 992 and Treas. Reg. § 1.992–2(a)(1)(i)	A qualifying corporation must file Form 4876–A or attachments thereto, containing the consent of every shareholder of the corporation to be treated as a DISC as of the beginning of the corporation's first taxable year.
32.	Sec. 992 and Treas. Reg. § 1.992–2(b)(2)	A qualifying corporation must file consents of the shareholders of the corporation to be treated as a DISC with the service center with which the DISC election was first filed, within 90 days after the first day of the taxable year, or within the time granted for an extension to file such consents.
33.	Sec. 992 and Treas. Reg. § 1.992–2(e)(2)	A corporation seeking to revoke a prior election to be treated as a DISC, must file a statement within the first 90 days of the taxable year in which the revocation is to take effect with the service center with which it filed the election or, if the corporation filed an annual information return, by filing the statement at the service center with which it filed its most recent annual information return.
34.	Sec. 992 and Treas. Reg. § 1.992–3(c)(3)	A DISC that makes a deficiency distribution with respect to the 95 percent of gross receipts test or the 95 percent assets test, or both tests, for a particular taxable year, must make such distribution within 90 days of the date of the first written notification from the IRS that the DISC failed to satisfy such test(s).
35.	Sec. 993 and Treas. Reg. § 1.993–3(d)(2)(i)(*b*)	In certain cases, property may not qualify as export property for DISC purposes unless, among other things, such property is ultimately delivered, directly used, or directly consumed outside the U.S. within one year of the date of sale or lease of the property.
36.	Sec. 1445 Treas. Reg. § 1.1445–1	Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, must be filed by a buyer or other transferee of a U.S. real property interest, and a corporation, partnership, or fiduciary that is required to withhold tax. The amount withheld is to be transmitted with Form 8288, which is generally to be filed by the 20th day after the date of transfer.
37.	Sec. 1446	All partnerships with effectively connected gross income allocable to a foreign partner in any tax year must file forms 8804, *Annual Return for Partnership Withholding Tax*, and 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax*, on or before the 15th day of the 4th month following the close of the partnership's taxable year.
38.	Sec. 1446	Form 8813, *Partnership Withholding Tax Payment Voucher*, is used to pay the withholding tax under section 1446 for all partnerships with effectively connected gross income allocable to a foreign partner in any tax year. Form 8813, *Partnership Withholding Tax Payment Voucher (Section 1446)*, must accompany each payment of section 1446 tax made during the partnership's taxable year. Form 8813 is to be filed on or before the 15th day of the 4th, 6th, 9th, and 12th months of the partnership's taxable year for U.S. income tax purposes.

	Statute or Regulation	Act Postponed
39.	Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A–4(d)(1)	A reporting corporation must cure any failure to furnish information or failure to maintain records within 90 days after the IRS gives notice of the failure to avoid the continuation penalty.
40.	Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A–4(d)(1)	A reporting corporation must cure any failure to furnish information or failure to maintain records before the beginning of each 30-day period after expiration of the initial 90-day period to avoid additional continuation penalties.
41.	Sec. 6038A(e)(1) and Treas. Reg. § 1.6038A–5(b)	A reporting corporation must furnish an authorization of agent within 30 days of a request by the IRS to avoid a penalty.
42.	Sec. 6038A(e)(4)(A)	A reporting corporation must commence any proceeding to quash a summons filed by the IRS in connection with an information request within 90 days of the date the summons is issued.
43.	Sec. 6038A(e)(4)(B)	A reporting corporation must commence any proceeding to review the IRS's determination of noncompliance with a summons within 90 days of the IRS's notice of noncompliance.
44.	Sec. 6038A and Treas. Reg. § 1.6038A–3(b)(3)	A reporting corporation must supply an English translation of records provided pursuant to a request for production within 30 days of a request by the IRS for a translation to avoid a penalty.
45.	Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(2)	A reporting corporation must, within 60 days of a request by the IRS for records maintained outside the United States, either provide the records to the IRS, or move them to the United States and provide the IRS with an index to the records to avoid a penalty.
46.	Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(2)(i)	A reporting corporation must supply English translations of documents maintained outside the United States within 30 days of a request by the IRS for translation to avoid a penalty.
47.	Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(4)	A reporting corporation must request an extension of time to produce or translate documents maintained outside the United States beyond the period specified in the regulations within 30 days of a request by the IRS to avoid a penalty.
48.	Secs. 6038, 6038B, and 6046A	The filing of Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, for those taxpayers who do not have to file an income tax return. The form is due at the time that an income tax return would have been due had the taxpayer been required to file an income tax return.
49.	Sec. 6662(e) and Treas. Reg. § 1.6662–6(d)(2)(iii)(A)	A taxpayer must provide, within 30 days of a request by the IRS, specified "principal documents" regarding the taxpayer's selection and application of transfer pricing method to avoid potential penalties in the event of a final transfer pricing adjustment by the IRS. *See also* Treas. Reg. § 1.6662–6(d)(2)(iii)(C) (similar requirement re: background documents).

SECTION 13. PARTNERSHIP AND S CORPORATION ISSUES

	Statute or Regulation	Act Postponed
1.	Treas. Reg. §§ 1.442–1(b)(1) and (3) and 1.706–1(b)(8)	A partnership may obtain approval of the Commissioner to adopt, change or retain an annual accounting period by filing Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, with such time as provided in administrative procedures published by the Commissioner.

	Statute or Regulation	Act Postponed
2.	Treas. Reg. § 1.743–1(k)(2)	A transferee that acquires, by sale or exchange, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within 30 days of the sale or exchange. A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner.
3.	Treas. Reg. § 1.754–1(c)(1)	Generally, a partnership may revoke a section 754 election by filing the revocation no later than 30 days after the close of the partnership taxable year with respect to which the revocation is intended to take effect.
4.	Treas. Reg. § 1.761–2(b)(3)	A partnership may generally elect to be excluded from subchapter K. The election will be effective unless within 90 days after the formation of the organization any member of the organization notifies the Commissioner that the member desires subchapter K to apply to such organization and also advises the Commissioner that he has so notified all other members of the organization. In addition, an application to revoke an election to be excluded from subchapter K must be submitted no later than 30 days after the beginning of the first taxable year to which the revocation is to apply.
5.	Treas. Reg. § 1.761–2(c)	A partnership requesting permission to be excluded from certain provisions of subchapter K must submit the request to the Commissioner no later than 90 days after the beginning of the first taxable year for which partial exclusion is desired.
6.	Sec. 1361(e)	In general, the trustee of the electing small business trust (ESBT) must file the ESBT election within the 2-month and 16-day period beginning on the day the stock is transferred to the trust. *See* Treas. Reg. § 1.1361–1(m)(2)(ii).
7.	Treas. Reg. § 1.1361–1(j)(6)	The current income beneficiary of a qualified subchapter S trust (QSST) must make a QSST election within the 2-month and 16-day period from one of the dates prescribed in section 1.1361–1(j)(6)(iii).
8.	Treas. Reg. § 1.1361–1(j)(10)	The successive income beneficiary of a QSST may affirmatively refuse to consent to the QSST election. The beneficiary must sign the statement and file the statement with the IRS within 15 days and 2 months after the date on which the successive income beneficiary becomes the income beneficiary.
9.	Treas. Reg. § 1.1361–3(a)(4)	If an S corporation elects to treat an eligible subsidiary as a qualified subchapter S subsidiary (QSUB), the election cannot be effective more than 2 months and 15 days prior to the date of filing the election.
10.	Treas. Reg. § 1.1361–3(b)(2)	An S corporation may revoke a QSUB election by filing a statement with the service center. The effective date of a revocation of a QSUB election cannot be more than 2 months and 15 days prior to the filing date of the revocation.
11.	Treas. Reg. § 1.1362–2(a)(2), (4)	If a corporation revokes its subchapter S election after the first 2½-months of its taxable year, the revocation will not be effective until the following taxable year. An S corporation may rescind a revocation of an S election at any time before the revocation becomes effective.
12.	Sec. 1362(b)(1)	An election under section 1362(a) to be an S corporation may be made by a small business corporation for any taxable year at any time during the preceding taxable year, or at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year.
13.	Rev. Proc. 2003–43	This revenue procedure provides a simplified method for taxpayers requesting relief for late S corporation elections, Qualified Subchapter S Subsidiary (QSUB) elections, Qualified Subchapter S Trust (QSST) elections, and Electing Small Business Trust (ESBT) elections. Generally, this revenue procedure provides that certain eligible entities may file late elections within 24 months of the due date of the election.

	Statute or Regulation	Act Postponed
14.	Rev. Proc. 2004–48	This revenue procedure provides a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election which was intended to be effective on the same date that the S corporation election was intended to be effective. This revenue procedure provides that within 6 months after the due date for the tax return, excluding extensions, for the first year the entity intended to be an S corporation, the corporation must file a properly completed Form 2553, *Election by a Small Business Corporation*, with the applicable service center.
15.	Sec. 1378(b) and Treas. Reg. § 1.1378–1(c)	An S or electing S corporation may obtain the approval of the Commissioner to adopt, change or retain an annual accounting period by filing Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, within such time as is provided in administrative procedures published by the Commissioner. *See* Rev. Procs. 2002–38 and 2002–39.

SECTION 14. PROCEDURE & ADMINISTRATION ISSUES

.01 Bankruptcy and Collection

	Statute or Regulation	Act Postponed
1.	Treas. Reg. § 301.6036–1(a)(2) and (3)	A court-appointed receiver or fiduciary in a non-bankruptcy receivership, a fiduciary in aid of foreclosure who takes possession of substantially all of the debtor's assets, or an assignee for benefit of creditors, must give written notice within ten days of his appointment to the IRS as to where the debtor will file his tax return.
2.	Sec. 6320(a)(3)(B) and (c) and Treas. Reg. § 301.6320–1(b), (c) and (f)	A taxpayer has 30 days after receiving a notice of a lien to request a Collection Due Process (CDP) administrative hearing. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court.
3.	Sec. 6330(a)(3)(B) and (d)(1) and Treas. Reg. § 301.6330–1(b), (c) and (f)	The taxpayer must request a Collections Due Process (CDP) administrative hearing within 30 days after the IRS sends notice of a proposed levy. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court.
4.	Sec. 6331(k)(1) and Treas. Reg. § 301.7122–1(g)(2)	If a taxpayer submits a good-faith revision of a rejected offer in compromise within 30 days after the rejection, the Service will not levy to collect the liability before deciding whether to accept the revised offer.
5.	Sec. 6331(k)(2) and Treas. Reg. § 301.6331–4(a)(1)	If, within 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, no levy may be made while the rejection or termination is being considered by Appeals.
6.	Sec. 7122(d)(2) and Treas. Reg. § 301.7122–1(f)(5)(i)	A taxpayer must request administrative review of a rejected offer in compromise within 30 days after the date on the letter of rejection.

.02 Information Returns

	Statute or Regulation	Act Postponed
1.	Sec. 6050I	Any person engaged in a trade or business receiving more than $10,000 cash in one transaction (or 2 or more related transactions) must file an information return, Form 8300, *Report of Cash Payments over $10,000 Received in a Trade or Business*, by the 15th day after the date the cash was received. Additionally, a statement must be provided to the person with respect to whom the information is required to be furnished by Jan. 31st of the year following.
2.	Sec. 6050L	Returns relating to certain dispositions of donated property, Forms 8282, *Donee Information Return*, must be filed within 125 days of the disposition.

.03 Miscellaneous

	Statute or Regulation	Act Postponed
1.	Sec. 1314(b)	A taxpayer may file a claim for refund or credit of tax based upon the mitigation provisions of sections 1311 through 1314 if, as of the date a determination (as defined in section 1313(a)) is made, one year remains on the period for filing a claim for refund.
2.	Sec. 6015	A requesting spouse must request relief under section 6015 within 2 years of the first collection activity against the requesting spouse.
3.	Sec. 6411	Taxpayers applying for a tentative carryback adjustment of the tax for the prior taxable year must file Form 1139, *Corporation Application for Tentative Refund,* (for corporations) or Form 1045, *Application for Tentative Refund,* (for entities other than corporations) within 12 months after the end of such taxable year that generates such net operating loss, net capital loss, or unused business credit from which the carryback results.
4.	Sec. 6656(e)(2)	A taxpayer who is required to deposit taxes and fails to do so is subject to a penalty under section 6656. Under section 6656(e)(2), the taxpayer may, within 90 days of the date of the penalty notice, designate to which deposit period within a specified tax period the deposits should be applied.

SECTION 15. TAX CREDIT ISSUES

	Statute or Regulation	Act Postponed
1.	Sec. 42(e)(3)(A)(ii)	A taxpayer has a 24-month measuring period in which the requisite amount of rehabilitation expenditures has to be incurred in order to qualify for treatment as a separate new building.
2.	Treas. Reg. § 1.42–5(c)(1)	The taxpayer must make certain certifications at least annually to the Agency.
3.	Treas. Reg. § 1.42–5(c)(1)(iii)	The taxpayer must receive an annual income certification from each low-income tenant with documentation to support the certification.
4.	Treas. Reg. § 1.42–8(a)(3)(v)	The taxpayer and an Agency may elect to use an appropriate percentage under section 42(b)(2)(A)(ii)(I) by notarizing a binding agreement by the 5th day following the end of the month in which the binding agreement was made.
5.	Treas. Reg. § 1.42–8(b)(1)(vii)	The taxpayer and an Agency may elect an appropriate percentage under section 42(b)(2)(A)(ii)(II) by notarizing a binding agreement by the 5th day following the end of the month in which the tax-exempt bonds are issued.

	Statute or Regulation	Act Postponed
6.	Sec. 42(d)(2)(D) (ii)(IV)	In order to claim section 42 credits on an existing building, section 42(d)(2)(B)(ii)(I) requires that the building must have been placed in service at least ten years before the date the building was acquired by the taxpayer. A building is not considered placed in service for purposes of section 42(d)(2)(B)(ii) if the building is resold within a 12-month period after acquisition by foreclosure of any purchase-money security interest.
7.	Sec. 42(g)(3)(A)	A building shall be treated as a qualified low-income building only if the project meets the minimum set aside requirement by the close of the first year of the credit period of the building.
8.	Sec. 42(h)(6)(J)	A low-income housing agreement commitment must be in effect as of the beginning of the year for a building to receive credit. If such a commitment was not in effect, the taxpayer has a one-year period for correcting the failure.
9.	Sec. 42(h)(1)(E) and (F)	The taxpayer's basis in the building project, as of the later of the date which is 6 months after the date the allocation was made or the close of the calendar year in which the allocation is made, must be more than 10 percent of the taxpayer's reasonably expected basis in the project.
10.	Sec. 47(c)(1)(C) and Treas. Reg. § 1.48–12(b)(2)	A taxpayer has a 24- or 60-month measuring period in which the requisite amount of rehabilitation expenditures have to be incurred in order to satisfy the "substantial rehabilitation" test.
11.	Treas. Reg. § 1.48–12(d)(7)	In the historic rehabilitation context, if the taxpayer fails to receive final certification of completed work prior to the date that is 30 months after the date that the taxpayer filed the return on which the credit is claimed, the taxpayer must, prior to the last day of the 30th month, consent to extending the statute of limitations by submitting a written statement to the Service.
12.	Sec. 51(d)(12)(A)(ii)(II) and 51A(d)(1)	An employer seeking the Work Opportunity Credit or the Welfare-to-Work Credit with respect to an individual must submit Form 8850, *Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits*, to the State Employment Security Agency not later than the 21st day after the individual begins work for the employer.

SECTION 16. TAX-EXEMPT BOND ISSUES

	Statute or Regulation	Act Postponed
1.	Treas. Reg. § 1.25–4T(c)	On or before the date of distribution of mortgage credit certificates under a program or December 31, 1987, the issuer must file an election not to issue an amount of qualified mortgage bonds. An election may be revoked, in whole or on part, at any time during the calendar year in which the election was made.
2.	Treas. Reg. §§ 1.141–12(d)(3) and 1.142–2(c)(2)	An issuer must provide notice to the Commissioner of the establishment of a defeasance escrow within 90 days of the date such defeasance escrow is established in accordance with sections 1.141–12(d)(1) or 1.142–2(c)(1).
3.	Sec. 142(d)(7)	An operator of a multi-family housing project for which an election was made under section 142(d) must submit to the Secretary an annual certification as to whether such project continues to meet the requirements of section 142(d).

	Statute or Regulation	Act Postponed
4.	Sec. 142(f)(4) and Treas. Reg. § 1.142(f)(4)–1	A person engaged in the local furnishing of electric energy or gas (a local furnisher) that uses facilities financed with exempt facility bonds under section 142(a)(8) and expands its service area in a manner inconsistent with the requirements of sections 142(a)(8) and 142(f), may make an election to ensure that those bonds will continue to be treated as exempt facility bonds. The election must be filed with the IRS on or before 90 days after the date of the service area expansion that causes the bonds to cease to meet the applicable requirements.
5.	Sec. 146(f) and Notice 89–12	If an issuing authority's volume cap for any calendar year exceeds the aggregate amount of tax-exempt private activity bonds issued during such calendar year by such authority, such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward purposes. Such election must be filed by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises, or (2) the date of issue of bonds issued pursuant to the carryforward election.
6.	Sec. 148(f)(3) and Treas. Reg. § 1.148–3(g)	An issuer of a tax-exempt municipal obligation must make any required rebate payment no later than 60 days after the computation date to which the payment relates. A rebate payment is paid when it is filed with the IRS at the place or places designated by the Commissioner. A payment must be accompanied by the form provided by the Commissioner for this purpose.
7.	Treas. Reg. § 1.148–5(c)	An issuer of a tax-exempt municipal obligation must make a yield reduction payment on or before the date of required rebate installment payments as described in section 1.148–3(f), (g), and (h).
8.	Sec. 148(f)(4)(C)(xvi) and Treas. Reg. § 1.148–7(k)(1)	As issuer of a tax-exempt municipal obligation that elects to pay certain penalties in lieu of rebate must make any required penalty payments not later than 90 days after the period to which the penalty relates.
9.	Sec. 149(e)	An issuer of a tax-exempt municipal obligation must submit to the Secretary a statement providing certain information regarding the municipal obligation not later than the 15th day of the 2nd calendar month after the close of the calendar quarter in which the municipal obligation is issued.

SECTION 17. SPECIAL RULES FOR SECTION 1031 LIKE-KIND EXCHANGE TRANSACTIONS

.01 (1) The last day of a 45-day identification period set forth in section 1.1031(k)–1(b)(2) of the Income Tax Regulations, the last day of a 180-day exchange period set forth in section 1.1031(k)–1(b)(2), and the last day of a period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, that falls on or after the date of a Presidentially declared disaster is postponed by 120 days or to the last day of the general disaster extension period authorized by an IRS News Release or other guidance announcing tax relief for victims of the specific Presidentially declared disaster, whichever is later, if such IRS News Release or other guidance provides relief for acts listed in this revenue procedure.

(2) A taxpayer who is a transferor qualifies for a postponement under section 17.01 only if—

(a) The relinquished property was transferred on or before the date of the Presidentially declared disaster, or in a transaction governed by Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, qualified *indicia* of ownership were transferred to the exchange accommodation titleholder on or before that date; and

(b) The taxpayer (transferor)—

(i) Is an "affected taxpayer" as defined in the IRS News Release or other guidance announcing tax relief for the victims of the specific Presidentially declared disaster; or

(ii) Has difficulty meeting the 45-day identification or 180-day exchange deadline set forth in section 1.1031(k)–1(b)(2), or a deadline set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, due to the Presidentially declared disaster for the following or similar reasons:

(A) The relinquished property or the replacement property is located in a covered disaster area (as defined in section 301.7508A–1(d)(2)) as provided in the IRS News Release or other guidance (the covered disaster area);

(B) The principal place of business of any party to the transaction (for example, a qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution, or a title insurance company) is located in the covered disaster area;

(C) Any party to the transaction (or an employee of such a party who is involved in the section 1031 transaction) is killed, injured, or missing as a result of the Presidentially declared disaster;

(D) A document prepared in connection with the exchange (for example, the agreement between the transferor and the qualified intermediary or the deed to the relinquished property or replacement property) or a relevant land record is de-

stroyed, damaged, or lost as a result of the Presidentially declared disaster;

(E) A lender decides not to fund either permanently or temporarily a real estate closing due to the Presidentially declared disaster or refuses to fund a loan to the taxpayer because flood, disaster, or other hazard insurance is not available due to the Presidentially declared disaster; or

(F) A title insurance company is not able to provide the required title insurance policy necessary to settle or close a real estate transaction due to the Presidentially declared disaster.

.02 The postponement described in section 17.01 also applies to the last day of a 45-day identification period described in section 1.1031(k)–1(b)(2) and the last day of a 45-day identification period described in section 4.05(4) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, that falls prior to the date of a Presidentially declared disaster if an identified replacement property (in the case of an exchange described in section 1.1031(k)–1), or an identified relinquished property (in the case of an exchange described in Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51) is substantially damaged by the Presidentially declared disaster.

.03 For purposes of this section 17, the deadlines to which the 120-day postponements apply do not include the due date of the taxpayer's tax return in section 1.1031(k)–1(b)(2), which is used to determine the last day of the exchange period.

.04 If the taxpayer (transferor) qualifies for relief under this section for any reason other than section 17.01(2)(b)(i), then such taxpayer is not considered an affected taxpayer for purposes of any other act listed in this revenue procedure or for any acts listed in an IRS News Release or other published guidance related to the specific Presidentially declared disaster.

SECTION 18. INQUIRIES

If you wish to recommend that other acts qualify for postponement, please write to the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), CC:PA:APJP:B2, 1111 Constitution Avenue, NW, Washington, DC 20224. Please mark "7508A List" on the envelope. In the alternative, e-mail your comments to: *Notice.Comments@irscounsel.treas.gov*, and refer to Rev. Proc. 2005–27 in the Subject heading.

SECTION 19. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 2004–13, 2004–4 I.R.B. 335, is superseded.

SECTION 20. EFFECTIVE DATE

This revenue procedure is effective for acts that may be performed on or after May 16, 2005.

SECTION 21. DRAFTING INFORMATION

The principal author of this revenue procedure is Dillon Taylor of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue procedure, contact Mr. Taylor at (202) 622–4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking, Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations, and Notice of Public Hearing

Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes

REG–159243–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9194) that provide rules under section 937(a) of the Internal Revenue Code (Code) for determining whether an individual is a bona fide resident of the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands. The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business within a U.S. possession. Section 937 was added to the Code by section 908 of the American Jobs Creation Act of 2004 (2004 Act).

The temporary regulations also provide updated guidance under sections 876, 881, 884, 931, 932, 933, 934, 935, 957, and 6688 of the Code to reflect amendments made by the Tax Reform Act of 1986 (1986 Act) and the 2004 Act. Conforming changes are also made to regulations under sections 170A, 861, 871, 901, 1402, 6038, 6046, and 7701 of the Code. The text of the temporary regulations on this subject in this issue of the Bulletin also generally serves as the text of these proposed regulations set forth in this cross-referenced notice of proposed rulemaking.

This notice of proposed rulemaking also contains proposed regulations that are in addition to the text of the temporary regulations. These provisions that are issued only as proposed regulations contain additional conforming changes to the regulations under sections 1, 861, 871, and 7701.

DATES: Written or electronic comments must be received by July 11, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for July 21, 2005, at 10:00 a.m., must be received by June 30, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–159243–03) room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–159243–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–159243–03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, J. David Varley at (202) 435–5165; concerning submissions, Treena Garrett at (202) 622–3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by July 11, 2005. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in the proposed and temporary regulations is in §1.937–1T. Section 937(a) of the Code provides rules for determining whether an individual is a bona fide resident of Guam, Puerto Rico, American Samoa, the USVI, or the Northern Mariana Islands. Section 937(c) requires an individual who claims to become, or cease to be, a resident of a U.S. possession to file notice of such claim in such manner as the Secretary prescribes.

Accordingly, §1.937–1T(g) requires individuals claiming to become, or cease to be, a resident of a U.S. possession to file notice of such claim with the Internal Revenue Service in accordance with section 937(c) of the Code. Individuals subject to this reporting requirement must retain information to establish their residency as required by section 937(c) of the Code and §1.937–1T.

The collection of information is mandatory. The likely respondents are individuals who become (or cease to be) bona fide residents of a U.S. possession.

Estimated total annual reporting burden: 75,000 hours.

Estimated average annual burden hours per respondent: 1.5 hours.

Estimated number of respondents: 50,000.

Estimated annual frequency of responses: annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend 26 CFR parts 1, 301, and 602. The temporary regulations provide rules concerning issues relating to U.S. possessions, including rules for determining whether an individual is a bona fide resident of a U.S. possession under section 937(a). The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business in a U.S. possession and rules under section 937(c) pertaining to certain reporting requirements for individuals who become (or cease to be) bona fide residents of a U.S. possession. Further, a number of sections in the Code relating to possessions were substantially revised by the 1986 Act. The temporary regulations amend regulations under affected and related sections to conform them to statutory revisions enacted by the 1986 Act and to other legislative amendments. Except as otherwise specified in this notice of proposed rulemaking, the text of the temporary regulations also serves as the text of these proposed regulations. This notice of proposed rulemaking also contains proposed regulations that are in addition to the text of the temporary regulations. These provisions that are issued only as proposed regulations contain additional conforming changes. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Proposed Effective Date

These regulations are generally proposed to apply for taxable years ending after October 22, 2004. For specific applicability dates, see the temporary regulations in this issue of the Bulletin.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing has been scheduled for July 21, 2005, at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 30, 2005. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Comments are requested on all aspects of the proposed regulations, including those aspects for which specific requests for comments are set forth above.

Drafting Information

The principal authors of these regulations are W. Edward Williams and J. David Varley, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.931–1 also issued under 26 U.S.C. 7654(e).

Section 1.932–1 also issued under 26 U.S.C. 7654(e).

Section 1.935–1 also issued under 26 U.S.C. 7654(e). * * *

Section 1.937–1 also issued under 26 U.S.C. 937(a).

Section 1.937–2 also issued under 26 U.S.C. 937(b).

Section 1.937–3 also issued under 26 U.S.C. 937(b). * * *

Section 1.957–3 also issued under 26 U.S.C. 957(c). * * *

Par. 2. In §1.1–1, the second sentence of paragraph (b) is revised to read as follows:

§1.1–1 Income tax on individuals.

* * * * *

(b) * * * Pursuant to section 876, a nonresident alien individual who is a bona fide resident of a section 931 possession (as defined in §1.931–1T(c)(1) of this chapter) or

Puerto Rico during the entire taxable year is, except as provided in section 931 or 933 with respect to income from sources within such possessions, subject to taxation in the same manner as a resident alien individual.
* * *

* * * * *

Par. 3. In §1.170A–1, paragraph (j)(9) is revised to read as follows:

§1.170A–1 Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(j) * * *

(9) [The text of the proposed amendment to §1.170A–1(j)(9) is the same as the text of §1.170–1T(j)(9) published elsewhere in this issue of the Bulletin].

Par. 4. In §1.861–3, paragraph (a)(2) is revised to read as follows:

§1.861–3 Dividends.

* * * * *

(a) * * *

(2) [The text of the proposed amendment to §1.861–3 is the same as the text of §1.861–3T(a)(2) published elsewhere in this issue of the Bulletin].

Par. 5. In §1.861–8, paragraphs (f)(1)(vi)(E), (F) and (H) are revised to read as follows:

§1.861–8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(f) * * *

(1) * * *

(vi) * * *

(E) The tax base for individuals entitled to the benefits of section 931 and the section 936 tax credit of a domestic corporation which has an election in effect under section 936;

(F) The exclusion for income from Puerto Rico for bona fide residents of Puerto Rico under section 933;

* * * * *

(H) The income derived from the U.S. Virgin Islands or from a section 935 possession (as defined in §1.935–1T(a)(3)(i)).

* * * * *

Par. 6. Section 1.871–1 is amended as follows:

1. Revise paragraph (b)(1)(iii).

2. Revise the last two sentences of the undesignated paragraph following paragraph (b)(1)(iii).

The revisions are as follows:

§1.871–1 Classification and manner of taxing alien individuals.

* * * * *

(b) * * *

(1) * * *

(iii) Nonresident alien individuals who are bona fide residents of a section 931 possession (as defined in §1.931–1T(c)(1) of this chapter) or Puerto Rico during the entire taxable year.

* * * The provisions of subpart A do not apply to individuals described in paragraph (b)(1)(iii) of this section, but such individuals, except as provided in section 931 or 933, are subject to the tax imposed by section 1 or 55. See §1.876–1.

Par. 7. Section 1.876–1 is revised to read as follows:

§1.876–1 Alien residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

[The text of the proposed amendment to §1.876–1 is the same as the text of §1.876–1T published elsewhere in this issue of the Bulletin].

Par. 8. Section 1.881–5 is added to read as follows:

§1.881–5 Exception for certain possessions corporations.

[The text of the proposed §1.881–5 is the same as the text of §1.881–5T published elsewhere in this issue of the Bulletin].

Par. 9. In §1.884–0, paragraph (b) is redesignated as paragraph (c), and a new paragraph (b) is added to read as follows:

§1.884–0 Overview of regulation provisions for section 884.

* * * * *

(b) [The text of the proposed amendment to §1.884–0 is the same as the text of §1.884–0T published elsewhere in this issue of the Bulletin].

Par. 10. In §1.901–1, paragraph (g) is revised to read as follows:

§1.901–1 Allowance of credit for taxes.

(g) [The text of the proposed amendment to §1.901–1(g) is the same as the text of §1.901–1T(g) published elsewhere in this issue of the Bulletin].

Par. 11. Section 1.931–1 is revised to read as follows:

§1.931–1 Exclusion of certain income from sources within Guam, American Samoa, or the Northern Mariana Islands.

[The text of the proposed amendment to §1.931–1 is the same as the text of §1.931–1T published elsewhere in this issue of the Bulletin].

Par. 12. Section 1.932–1 is revised to read as follows:

§1.932–1 Coordination of United States and Virgin Islands income taxes.

[The text of the proposed amendment to §1.932–1 is the same as the text of §1.932–1T published elsewhere in this issue of the Bulletin].

Par. 13. Section 1.933–1 is amended by revising paragraphs (a) and (c) and adding paragraphs (d) and (e) to read as follows:

§1.933–1 Exclusion of certain income from sources within Puerto Rico.

(a) [The text of the proposed amendment to §1.933–1(a) is the same as the text of §1.933–1T(a) published elsewhere in this issue of the Bulletin].

* * * * *

(c) [The text of the proposed amendment to §1.933–1(c) is the same as the text of §1.933–1T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of the proposed amendment to §1.933–1(d) is the same as the text of §1.933–1T(d) published elsewhere in this issue of the Bulletin].

(e) [The text of the proposed amendment to §1.933–1(e) is the same as the text of §1.933–1T(e) published elsewhere in this issue of the Bulletin].

Par. 14. Section 1.934–1 is revised to read as follows:

§1.934–1 Limitation on reduction in income tax liability incurred to the Virgin Islands.

[The text of the proposed amendment to §1.934–1 is the same as the text of

§1.934–1T published elsewhere in this issue of the Bulletin].

Par. 15. Section 1.935–1 is amended as follows:

1. Revise paragraphs (a)(1) through (a)(3).

2. Revise paragraphs (b)(1) and (b)(3), and add paragraphs (b)(5) through (b)(7).

3. Revise paragraphs (c) through (f).

4. Add paragraph (g).

The revisions and additions are as follows:

§1.935–1 Coordination of individual income taxes with Guam and the Northern Mariana Islands.

(a)(1) through (a)(3) [The text of the proposed amendment to §1.935–1(a)(1) through (a)(3) is the same as the text of §1.935–1T(a)(1) through (a)(3) published elsewhere in this issue of the Bulletin].

(b)(1) [The text of the proposed amendment to §1.935–1(b)(1) is the same as the text of §1.935–1T(b)(1) published elsewhere in this issue of the Bulletin].

* * * * *

(b)(3) [The text of the proposed amendment to §1.935–1(b)(3) is the same as the text of §1.935–1T(b)(3) published elsewhere in this issue of the Bulletin].

* * * * *

(b)(5) through (b)(7) [The text of the proposed §1.935–1(b)(5) through (b)(7) is the same as the text of §1.935–1T(b)(5) through (b)(7) published elsewhere in this issue of the Bulletin].

(c) [The text of the proposed amendment to §1.935–1(c) is the same as the text of §1.935–1T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of the proposed amendment to §1.935–1(d) is the same as the text of §1.935–1T(d) published elsewhere in this issue of the Bulletin.

(e) [The text of the proposed amendment to §1.935–1(e) is the same as the text of §1.935–1T(e) published elsewhere in this issue of the Bulletin].

(f) [The text of the proposed amendment to §1.935–1(f) is the same as the text of §1.935–1T(f) published elsewhere in this issue of the Bulletin].

(g) [The text of the proposed §1.935–1(g) is the same as the text of §1.935–1T(g) published elsewhere in this issue of the Bulletin].

Par. 16. Section 1.937–1 is added to read as follows:

§1.937–1 Bona fide residency in a possession.

[The text of the proposed §1.937–1 is the same as the text of §1.937–1T published elsewhere in this issue of the Bulletin].

Par. 17. Section 1.937–2 is added as follows:

§1.937–2 Income from sources within a possession.

[The text of the proposed §1.937–2 is the same as the text of §1.937–2T published elsewhere in this issue of the Bulletin].

Par. 18. Section 1.937–3 is added to read as follows:

§1.937–3 Income effectively connected with the conduct of a trade or business in a possession.

[The text of the proposed §1.937–3 is the same as the text of §1.937–3T published elsewhere in this issue of the Bulletin].

Par. 19. Section 1.957–3 is revised to read as follows:

§1.957–3 United States person defined.

[The text of the proposed amendment to §1.957–3 is the same as the text of §1.957–3T published elsewhere in this issue of the Bulletin].

Par. 20. Section 1.1402(a)–12 is revised to read as follows:

§1.1402(a)–12 Continental shelf and possessions of the United States.

[The text of the proposed amendment to §1.1402(a)–12 is the same as the text of §1.1402(a)–12T published elsewhere in this issue of the Bulletin].

Par. 21. In §1.6038–2, paragraph (d) is revised to read as follows:

§1.6038–2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(d) [The text of the proposed amendment to §1.6038–2(d) is the same as the text of §1.6038–2T(d) published elsewhere in this issue of the Bulletin].

Par. 22. In §1.6046–1, paragraph (f)(3) is revised to read as follows:

§1.6046–1 Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.

* * * * *

(f) * * *

(3) [The text of the proposed amendment to §1.6046–1(f)(3) is the same as the text of §1.6046–1T(f)(3) published elsewhere in this issue of the Bulletin].

PART 301 — PROCEDURE AND ADMINISTRATION

Par. 23. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 24. Section 301.6688–1 is revised to read as follows:

§301.6688–1 Assessable penalties with respect to information required to be furnished with respect to possessions.

[The text of the proposed amendment to §301.6688–1 is the same as the text of §301.6688–1T published elsewhere in this issue of the Bulletin].

Par. 25. In §301.7701–3, paragraph (c)(1)(i) is amended by adding a final sentence to read as follows:

§301.7701–3 Classification of certain business entities.

* * * * *

(c) * * *

(1) * * *

(i) * * * For entity status consistency rules with respect to certain possessions of the United States, see §§1.932–1T(h) and 1.935–1T(e).

* * * * *

Par. 26. In §301.7701(b)–1, paragraph (d) is revised to read as follows:

§301.7701(b)–1 Resident alien.

* * * * *

(d) [The text of the proposed amendment to §301.7701(b)–1(d) is the same as the text of §301.7701(b)–1T(d) published elsewhere in this issue of the Bulletin].

Linda M. Kroening,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on April 6, 2005, 11:05 a.m., and published in the issue of the Federal Register for April 11, 2005, 70 F.R. 18949)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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