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1504(a) is not a member of the affiliated group for purposes of determining the amount of foreign source alternative minimum taxable income within each separate category and the alternative minimum tax foreign tax credit pursuant to section 59(a).

(iii) *Effective date.* This paragraph (d)(2) applies to taxable years beginning after December 31, 1989.

(d)(3) through (e)(5) [Reserved]. For further guidance, see §1.861–14T(d)(3) through (e)(5).

(e)(6) *Charitable contribution expenses*—(i) *In general.* A deduction for a charitable contribution by a member of an affiliated group shall be allocated and apportioned under the rules of §§1.861–8(e)(12) and 1.861–14T(c)(1).

(ii) *Effective date.* (A) The rules of this paragraph shall apply to charitable contributions subject to §1.861–8(e)(12)(i) that are made on or after July 28, 2004, and, for taxpayers applying the second sentence of §1.861–8(e)(12)(iv)(A), to charitable contributions made during the taxable year ending on or after July 28, 2004.

(B) The rules of this paragraph shall apply to charitable contributions subject to §1.861–8(e)(12)(ii) that are made on or after July 14, 2005, and, for taxpayers applying the second sentence of §1.861–8(e)(12)(iv)(B), to charitable contributions made during the taxable year ending on or after July 14, 2005.

(f) through (j) [Reserved] For further guidance, see §1.861–14T(f) through (j).

[T.D. 8916, 66 FR 274, Jan. 3, 2001, as amended by T.D. 9211, 70 FR 40663, July 14, 2005]

§1.861–14T Special rules for allocating and apportioning certain expenses (other than interest expense) of an affiliated group of corporations (temporary).

(a) *In general.* Section 1.861–11T provides special rules for allocating and apportioning interest expense of an affiliated group of corporations. The rules of this §1.861–14T also relate to affiliated groups of corporations and implement section 864(e)(6), which requires affiliated group allocation and apportionment of expenses other than interest which are not directly allocable and apportionable to any specific income producing activity or property. In general, the rules of this section apply to taxable years beginning after December 31, 1986. Paragraph (b) of this section describes the scope of the application of the rule for the allocation and apportionment of such expenses of affiliated groups of corporations. Such rule is then set forth in paragraph (c) of this section. Paragraph (d) of this section contains the definition of the term ''affiliated group'' for purposes of this section. Paragraph (e) of this section describes the expenses subject to allocation and apportionment under the rules of this section. Paragraph (f) of this section provides rules concerning the affiliated group allocation and apportionment of such expenses in computing the combined taxable income of a FSC or DISC and its related supplier. Paragraph (g) of this section describes the treatment of losses caused by apportionment of such expenses in the case of an affiliated group that does not file a consolidated return. Paragraph (h) of this section provides rules concerning the treatment of the reserve expenses of a life insurance company. Paragraph (j) of this section provides examples illustrating the application of this section.

(b) *Scope*—(1) *Application of section 864(e)(6).* Section 864(e)(6) and this section apply to the computation of taxable income for purposes of computing separate limitations on the foreign tax credit under section 904. Section 864(e)(6) and this section also apply in connection with section 907 to determine reductions in the amount allowed as a foreign tax credit under section 901. Section 864(e)(6) and this section also apply to the computation of the combined taxable income of the related supplier and a foreign sales corporation (FSC) (under sections 921 through 927) as well as the combined taxable income of the related supplier and a domestic international sales corporation (DISC) (under sections 991 through 997).

(2) *Nonapplication of section 864(e)(6).* Section 864(e)(6) and this section do not apply to the computation of subpart F income of controlled foreign corporations (under sections 951 through 964) or the computation of effectively connected taxable income of foreign corporations.

(3) *Application of section 864(e)(6) to the computation of combined taxable income*

of a possessions corporation and its affiliates. [Reserved]

(c) *General rule for affiliated corporations*—(1) *General rule*. (i) Except as otherwise provided in paragraph (c)(2) of this section, the taxable income of each member of an affiliated group within each statutory grouping shall be determined by allocating and apportioning the expenses described in paragraph (e) of this section of each member according to apportionment fractions which are computed as if all members of such group were a single corporation. For purposes of determining these apportionment fractions, any interaffiliate transactions or property that are duplicative with respect to the measure of apportionment chosen shall be eliminated. For example, in the application of an asset method of apportionment, stock in affiliated corporations shall not be taken into account, and loans between members of an affiliated group shall be treated in accordance with the rules of §1.861–11T(e). Similarly, in the application of a gross income method of apportionment, interaffiliate dividends and interest, gross income from sales or services, and other interaffiliate gross income shall be eliminated. Likewise, in the application of a method of apportionment based on units sold or sales receipts, interaffiliate sales shall be eliminated.

(ii) Except as otherwise provided in this section, the rules of §1.861–8T apply to the allocation and apportionment of the expenses described in paragraph (e) of this section. Thus, allocation under this paragraph (c) is accomplished by determining, with respect to each expense described in paragraph (e), the class of gross income to which the expense is definitely related and then allocating the deduction to such class of gross income. For this purpose, the gross income of all members of the affiliated group must be taken in account. Then, the expense is apportioned by attributing the expense to gross income (within the class to which the expense has been allocated) which is in the statutory grouping and to gross income (within the class) which is in the residual grouping. Section 1.861–8T(c)(1) identifies a number of factors upon which apportionment may be based, such as comparison of units sold, gross sales or receipts, assets used, or gross income. The apportionment method chosen must be applied consistently by each member of the affiliated group in apportioning the expense when more than one member incurred the expense or when members incurred separate portions of the expense. The apportionment fraction must take into account the apportionment factors contributed by all members of the affiliated group. In the case of an affiliated group of corporations that files a consolidated return, consolidated foreign tax credit limitations are computed for the group in accordance with the rules of §1.1502–4. For purposes of this section the term ''taxpayer'' refers to the affiliated group (regardless of whether the group files a consolidated return), rather than to the separate members thereof.

(2) *Expenses relating to fewer than all members*. An expense relates to fewer than all members of an affiliated group if the expense is allocable under paragraph (e)(1) of this section to gross income of at least one member other than the member that incurred the expense but fewer than all members of the affiliated group. The taxable income of the member that incurred the expense shall be determined by apportioning that expense under the rules of paragraph (c)(1) of this section as if the members of the affiliated group that derive gross income to which such expense is allocable under paragraph (e)(1) were treated as a single corporation.

(3) *Prior application of section 482*. The rules of this section do not supersede the application of section 482 and the regulations thereunder. Section 482 may be applied effectively to deny a deduction for an expense to one member of an affiliated group and to allow a deduction for that expense to another member of the affiliated group. In cases to which section 482 is applied, expenses shall be reallocated and reapportioned under section 864(e)(6) and this section after taking into account the application of section 482.

(d)(1)–(2) [Reserved]. For further guidance, see §1.861–14(d)(1) and (2).

(e) *Expenses to be allocated and apportioned under this section*—(1) *Expenses*

not directly traceable to specific income producing activities or property. (i) The expenses that are required to be allocated and apportioned under the rules of this section are expenses related to certain supportive functions, research and experimental expenses, stewardship expenses, and legal and accounting expenses, to the extent that such expenses are not directly allocable to specific income producing activities or property solely of the member of the affiliated group that incurred the expense. Interest expense of members of an affiliated group of corporations is allocated and apportioned under § 1.861–11T and not under the rules of this section. Expenses that are included in inventory costs or that are capitalized are not subject to allocation and apportionment under the rules of this section.

(ii) An item of expense is not considered to be directly allocable to specific income producing activities or property solely of the member incurring the expense if, were all members of the affiliated group treated as a single corporation, the expense would not be considered definitely related, within the meaning of § 1.861–8T(b)(2), only to a class of gross income derived solely by the member which actually incurred the expense. Furthermore, the expense is presumed not to be definitely related only to a class of gross income derived solely by the member incurring the expense (and is, therefore, presumed not to be directly allocable to specific income producing activities or property of that member) unless the taxpayer is able affirmatively to establish otherwise. As provided in paragraph (c)(1) of this section, expenses described in this paragraph (e)(1) generally shall be apportioned by the member incurring the expense according to apportionment fractions computed as if all members of the affiliated group were a single corporation. Under paragraph (c)(2) of this section, however, an expense shall be apportioned according to apportionment fractions computed as if only some (but fewer than all) members of the affiliated group were a single corporation, if the expense is considered allocable to gross income of at least one member other than the member incurring the expense but fewer than all members of the affiliated group. An item of expense shall be considered to be allocable to gross income of fewer than all members of the group if, were all members of the affiliated group treated as a single corporation, the expense would not be considered definitely related within the meaning of § 1.861–8T(b)(2) to gross income derived by all members of the group. In such case, the expense shall be considered allocable, for purposes of paragraph (c)(2) of this section, to gross income of those members of the group that generated (or could reasonably be expected to generate) the gross income to which the expense would be considered definitely related if the group were treated as a single corporation.

(2) *Research and experimental expenses*—(i) *In general*. The allocation and apportionment of research and experimental expenses is governed by the rules of § 1.861–8T(e)(3). In the case of research and experimental expenses incurred by a member of an affiliated group, the rules of § 1.861–8T(e)(3) shall be applied as if all members of the affiliated group were a single taxpayer. Thus, research and experimental expenses shall be allocated to all income of all members of the affiliated group reasonably connected with the relevant broad product category to which such expenses are definitely related under § 1.861–8T(e)(3)(i). If fewer than all members of the affiliated group derive gross income reasonably connected with that relevant broad product cagetory, then such expenses shall be apportioned under the rules of this paragraph (c)(2) only among those members, as if those members were a single corporation. See *Example* (1) of paragraph (j) of this section. Such expenses shall then be apportioned, if the sales method is used, in accordance with the rules of § 1.861–8T(e)(3)(ii) between the statutory grouping (within the class of gross income) and the residual grouping (within the class of gross income) taking into account the amount of sales of all members of the affiliated group from the product category which resulted in such gross income. Section 1.861–8T(e)(3)(ii)(D), relating to sales of controlled parties, shall be applied as if all members of

the affiliated group were the ''taxpayer'' referred to therein. If either of the optional gross income methods of apportionment is used, gross income of all members of the affiliated group that generate, have generated, or could reasonably have been expected to generate gross income within the relevant class of gross income must be taken into account.

(ii) *Expenses subject to the statutory moratorium.* The rules of this section do not apply to research and experimental expenses allocated under section 126 of Pub. L. 98–368.

(3) *Expenses related to supportive functions.* Expenses which are supportive in nature (such as overhead, general and administrative, supervisory expenses, advertising, marketing, and other sales expenses) are to be allocated and apportioned in accordance with the rules of §1.861–8T(b)(3). To the extent that such expenses are not directly allocable under paragraph (e)(1)(ii) of this section to specific income producing activities or property of the member of the affiliated group that incurred the expense, such expenses must be allocated and apportioned as if all members of the affiliated group were a single corporation in accordance with the rules of paragraph (c) of this section. Specifically, such expenses must be allocated to a class of gross income that take into account gross income that is generated, has been generated, or could reasonably have been expected to have been generated by the members of the affiliated group. If the expenses relate to the gross income of fewer than all members of the affiliated group as determined under paragraph (c)(2) of this section, then those expenses must be apportioned under the rules of paragraph (c)(2) of this section, as if those fewer members were a single corporation. See *Example* (3) of paragraph (j) of this section. Such expenses must be apportioned between statutory and residual groupings of income within the appropriate class of gross income by reference to the apportionment factors contributed by the members of the affiliated group that are treated as a single corporation.

(4) *Stewardship expenses.* Stewardship expenses are to be allocated and apportioned in accordance with the rules of §1.861–8T(e)(4). In general, stewardship expenses are considered definitely related and allocable to dividends received or to be received from a related corporation. If members of the affiliated group, other than the member that incurred the stewardship expense, receive or may receive dividends from the related corporation, such expense must be allocated and apportioned in accordance with the rules of paragraph (c) of this section as if all such members of the affiliated group that receive or may receive dividends were a single corporation. See *Example* (4) of paragraph (j) of this section. Such expenses must be apportioned between statutory and residual groupings of income within the appropriate class of gross income by reference to the apportionment factors contributed by the members of the affiliated group treated as a single corporation.

(5) *Legal and accounting fees and expenses.* Legal and accounting fees and expenses are to be allocated and apportioned under the rules of §1.861–8T (e)(5). To the extent that such expenses are not directly allocable under paragraph (e)(1)(ii) of this section to specific income producing activities or property of the member of the affiliated group that incurred the expense, such expenses must be allocated and apportioned as if all members of the affiliated group were a single corporation. Specifically, such expenses must be allocated to a class of gross income that takes into account the gross income which is generated, has been generated, or could reasonably have been expected to have been generated by the other members of the affiliated group. If the expenses relate to the gross income of fewer than all members of the affiliated group as determined under paragraph (c)(2) of this section, then those expenses must be apportioned under the rules of paragraph (c)(2) of this section, as if those fewer members were a single corporation. See *Example* (5) of paragraph (j) of this section. Such expenses must be apportioned taking into account the apportionment factors contributed by the members of the group that are treated as a single corporation.

(f) *Computation of FSC or DISC combined taxable income.* In the computation under the pricing rules of sections 925 and 994 of the combined taxable income of any FSC or DISC and its related supplier which are members of an affiliated group, the combined taxable income of such FSC or DISC and its related supplier shall be reduced by the portion of the expenses of the affiliated group described in paragraph (e) of this section that is incurred in connection with export sales involving that FSC or DISC. In order to determine the portion of the expenses of the affiliated group that is incurred in connection with export sales by or through a FSC or DISC, the portion of the total of the apportionment factor chosen that relates to the generation of that export income must be determined. Thus, if gross income is the apportionment factor chosen, the portion of total gross income of the affiliated group that consists of combined gross income derived from transactions involving the FSC or DISC and related supplier must be determined. Similarly, if units sold or sales receipts is the apportionment factor chosen, the portion of total units sold or sales receipts that generated export income of the FSC or DISC and related supplier must be determined. The amount of the expense shall then be multiplied by a fraction, the numerator of which is the export related apportionment factor as determined above, and the denominator of which is the total apportionment factor. Thus, if gross income is the apportionment factor chosen, apportionment is based on a fraction, the numerator of which is export related combined gross income of the FSC or DISC and related supplier and the denominator of which is the total gross income of the affiliated group. Similarly, if units sold or sales receipts is the apportionment factor chosen, the fraction is the units sold or sales receipts that generated export income of the FSC or DISC and related supplier over the total units sold or sales receipts of the affiliated group. Under this rule, expenses of other group members may be attributed to the combined gross income of a FSC of DISC and its related supplier without affecting the amount of expenses (other than any commission payable by the related supplier to the FSC or DISC) otherwise deductible by the FSC or DISC, the related supplier, or other members of the affiliated group. The FSC or DISC must calculate combined taxable income, taking into account any reduction by expenses attributed from other members of the affiliated group to determine the commission derived by the FSC or DISC or the transfer price of qualifying export property sold to the FSC or DISC.

(g) *Losses created through apportionment.* In the case of an affiliated group that does not file a consolidated return, the taxable income in any separate limitation category must be adjusted under this paragraph (g) for purposes of computing the separate foreign tax credit limitations under section 904(d). As a consequence of the affiliated group allocation and apportionment of expenses required by section 864(e)(6) and this section, expenses of a group member may be apportioned for section 904 purposes to a limitation category with a consequent loss in that limitation category. For purposes of this paragraph, the term ''limitation category'' includes domestic source income, as well as the types of income described in section 904(d)(1) (A) through (I). A loss of one affiliate in a limitation category will reduce the income of another member in the same limitation category if a consolidated return is filed. (*See* § 1.1502–4.) If a consolidated return is not filed, this netting does not occur. Accordingly, in such a case, the following adjustments among members are required, in order to give effect to the group allocation of expense:

(1) Losses created through group apportionment of expense in one or more limitation categories within a given member must be eliminated; and

(2) A corresponding amount of income of other members in the same limitation category must be recharacterized.

Such adjustments shall be accomplished in accordance with the rules of § 1.861–11T(g).

(h) *Special rule for the allocation of reserve expenses of a life insurance company.* An amount of reserve expenses of a life insurance company equal to the dividends received deduction that is

disallowed because it is attributable to the policyholders' share of dividends received shall be treated as definitely related to such dividends. The remaining reserve expenses of such company shall be allocated and apportioned under the rules of § 1.861–8 and this section.

(i) [Reserved]

(j) *Examples*. The rules of this section may be illustrated by the following examples. All of these examples assume that section 482 has not been applied by the Commissioner.

Example 1: (i) *Facts*. P owns all of the stock of X and all of the stock of Y. P, X and Y are domestic corporations. P is a holding company for the stock of X and Y. Both X and Y manufacture and sell a product which is included in a broad product category listed in § 1.861–8(e)(3)(i). During 1988, X incurred $100,000 on research connected with that product. All of the research was performed in the United States. In 1988, the domestic sales by X of the product totalled $400,000 and the foreign sales of the product totalled $200,000; Y's domestic sales of the product totalled $200,000 and Y's foreign sales of the product totalled $200,000. In 1988, X's gross income is $300,000, of which $200,000 is from domestic sales and $100,000 is from foreign sales; Y's gross income is $200,000 of which $100,000 is from domestic sales and $100,000 is from foreign sales.

(ii) P, X and Y are affiliated corporations within the meaning of section 864(e)(5) and this section. The research expenses incurred by X are allocable to all income connected with the relevant broad category listed in § 1.861–8T(e)(3)(i). Both X and Y have gross income includible within the class of gross income related to that product category. Accordingly, the research and experimental expenses incurred by X are to be allocated and apportioned as if X and Y were a single corporation. The apportionment for 1988 is as follows:

Tentative Apportionment on the Basis of Sales

Research expenses to be apportioned $100,000
Exclusive apportionment to United States source gross income..... $30,000
Research expense to be apportioned on the basis of sales..... $70,000

Apportionment of research expense to foreign source general limitation income:

$$\$70,000 \times \frac{\$200,000 + \$200,000}{\$600,000 + \$400,000} = \$28,000$$

Apportionment of research expense to United States source gross income:

$$\$70,000 \times \frac{\$400,000 + \$200,000}{\$600,000 + \$400,000} = \$42,000$$

Total apportioned deduction for research $100,000
Of which—
Apportioned to foreign source gross income $28,000
Apportioned to U.S. source gross income ($30,000+$42,000) $72,000

Tentative Apportionment on the Basis of Gross Income

Research expense apportioned to foreign source gross income:

$$\$100,000 \times \frac{\$100,000 + \$100,000}{\$300,000 + \$200,000} = \$40,000$$

Research expense apportioned to United States income:

$$\$100,000 \times \frac{\$200,000 + \$100,000}{\$300,000 + \$200,000} = \$60,000$$

Example 2: (i) *Facts.* P owns all of the stock of X, which owns all of the stock of Y. P, X and Y are all domestic corporations. P has incurred general training program expenses of $100,000 in 1987. Employees of P, X and Y participate in the training program. In 1987, P had United States source gross income of $200,000 and foreign source general limitation income of $200,000; X had U.S. source gross income of $100,000 and foreign source general limitation income of $100,000; and Y had U.S. source gross income of $300,000 and foreign source general limitation income of $100,000.

(ii) *Analysis.* P, X and Y are an affiliated group of corporations within the meaning of section 864(e)(5). The training expenses incurred by P are not definitely related solely to specific income producing activities or property of P. The employees of X and Y also participate in the training program. Thus, this expense relates to gross income generated by P, X and Y. This expense is definitely related and allocable to all of the gross income from foreign and domestic sources of P, X and Y. It is assumed that apportionment on the basis of gross income is reasonable. The apportionment of the expense is as follows:

Apportionment of $100,000 expense to foreign source general limitation income:

$$\$100,000 \times \frac{\$200,000 + \$100,000 + \$100,000}{\$400,000 + \$200,000 + \$400,000} = \$40,000$$

Apportionment of $100,000 expense to United States source gross income:

$$\$100,000 \times \frac{\$200,000 + \$100,000 + \$300,000}{\$400,000 + \$200,000 + \$400,000} = \$60,000$$

Total apportioned expense $100,000

Example 3: (i) *Facts.* The facts are the same as in *Example* (2) above, except that only employees of P and X participate in the training program.

(ii) *Analysis.* Because only the employees of P and X participate in the training program and they perform no services for Y, the expense relates only to gross income generated by P and X. Accordingly, the $100,000 expense must be allocated and apportioned as if P and X were a single corporation. The apportionment of the $100,000 expense is as follows:

Apportionment of $100,000 expense to foreign source general limitation income:

$$\$100,000 \times \frac{\$200,000 + \$100,000}{\$400,000 + \$200,000} = \$50,000$$

Apportionment of $100,000 expense to U.S. source gross income:

$$\$100{,}000 \times \frac{\$200{,}000 + \$100{,}000}{\$400{,}000 + \$200{,}000} = \$50{,}000$$

Example 4: (i) *Facts.* P owns all of the stock of X which owns all of the stock of Y. P and X are domestic corporations; Y is a foreign corporation. In 1987 P incurred $10,000 of stewardship expenses relating to an audit of Y.

(ii) *Analysis.* The stewardship expenses incurred by P are not directly allocable to specific income producing activities or property of P. The expense is definitely related and allocable to dividends received or to be received by X. Accordingly, the expense of P is allocated and apportioned as if P and X were a single corporation. The expense is definitely related to dividends received or to be received by X from Y, a foreign corporation. Such dividends are foreign source general limitation income. Thus, the entire amount of the expense must be allocated to foreign source dividend income.

Example 5: (i) *Facts.* P owns all of the stock of X which owns all of the stock of Y. P, X and Y are all domestic corporations. In 1987, P incurred $10,000 legal expense relating to the testimony of certain employees of P in connection with litigation to which Y is a party. This expense is not allocable to specific income of Y. In 1987, Y had $100,000 foreign source general limitation income and $300,000 U.S. source gross income.

(ii) *Analysis.* The legal expenses incurred by P are not definitely related solely to specific income producing activities or property of P. The expense is definitely related and allocable to the class of gross income which includes only gross income generated by Y. Accordingly, the expense of P is allocated and apportioned as if Y were the only member of the affiliated group, as follows:

Apportionment of legal expenses to foreign source general limitation income:

$$\$10{,}000 \times \frac{\$100{,}000}{\$400{,}000} \ldots\ldots \$2{,}500$$

Apportionment of legal expenses to U.S. source gross income:

$$\$10{,}000 \times \frac{\$300{,}000}{\$400{,}000} \ldots\ldots \$7{,}500$$

Example 6: (i) *Facts.* P owns all of the stock of R, which owns all of the stock of F. P and R are domestic corporations, and F is a foreign sales corporation under section 922 of the Code. R and F have entered into an agreement whereby F is paid a commission with respect to sales of product A. In 1987, P had gross receipts of $1,000,000 from domestic sales of product A, and gross receipts of $1,000,000 from foreign sales of product A. R had gross receipts of $1,000,000 from domestic sales of product A, and $1,000,000 from export sales of product A. R's cost of goods sold attributable to export sales is $500,000. R has deductible expenses of $100,000 directly related to its export sales, and F has such deductible expenses of $100,000. During 1987, P incurred an expense of $100,000 for marketing studies involving the worldwide market for product A.

(ii) *Analysis.* P and R are an affiliated group of corporations within the meaning of section 864(e)(5) and this section. The expense incurred by P for marketing studies regarding the worldwide market for product A is an expense that is not directly related solely to the activities of P, but also to the activities of R. This expense must be allocated and apportioned under the rules of paragraph (c)(1) of this section, as if P and R were a single corporation. The expense is allocable to the class of gross income that includes all gross income generated by sales of product A. Apportionment on the basis of gross receipts is reasonable under these facts. F, a foreign corporation, is not a member of the affiliated group. However, for purposes of determining F's commission on its sales, the combined gross income of F and R must be reduced by the portion of the marketing studies expense of P that is incurred in connection with export sales involving F under the rules of paragraph (f) of this section. The computation of the combined taxable income of R and F is as follows:

Combined Taxable Income of R and F

R's gross receipts from export sales	$1,000,000
R's cost of goods sold	$500,000
Combined Gross Income	$500,000
Less:	
R's other deductible expenses	$100,000
F's other deductible expenses	100,000
Apportionment of P's expense:	

$$\$100{,}000 \times \frac{\$1{,}000{,}000}{\$200{,}000 + \$2{,}000{,}000} \ldots\ldots \$25{,}000$$

Total	$225,000
Combined Taxable Income	$275,000

(k) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

[T.D. 8228, 53 FR 35501, Sept. 14, 1988, as amended by T.D. 8916, 65 FR 274, Jan. 3, 2001; T.D. 9143, 69 FR 44932, July 28, 2004; T.D. 9211, 70 FR 40663, July 14, 2005; T.D.9456, 74 FR 38875, Aug. 4, 2009]

§ 1.861–15 Income from certain aircraft or vessels first leased on or before December 28, 1980.

(a) *General rule.* A taxpayer who owns an aircraft or vessel described in paragraph (b) of this section and who leases the aircraft or vessel to a United States person (other than a member of the same controlled group of corporations (as defined in section 1563) as the taxpayer) may elect under paragraph (f) of this section to treat all amounts includible in gross income with respect to the aircraft or vessel as income from sources within the United States for any taxable year ending after the commencement of the lease. This paragraph (a) applies only with respect to taxable years ending after August 15, 1971, and only with respect to leases entered into after that date of aircraft or vessels first leased by the taxpayer on or before December 28, 1980. An election once made applies to the taxable year for which made and to all subsequent taxable years unless it is revoked or terminated in accordance with paragraph (g) of this section. A taxpayer need not be a United States person to be eligible to make the election under this section, unless otherwise required by a provision of law not contained in the Internal Revenue Code of 1954. In addition, the taxpayer need not be a bank or other financial institution to be eligible to make this election. The term ''United States person'' as used in this section has the meaning assigned to it by section 7701(a)(30).

(b) *Property to which the election applies*—(1) *Section 38 property.* An election made under this section may be made only if the aircraft or vessel is section 38 property, or property which would be section 38 property but for section 48(a)(5) (relating to property used by governmental units), at the time the election is made and for all taxable years to which the election applies. The aircraft or vessel must be property which qualifies for the investment credit under section 38 unless the property does not qualify because it is described in section 48(a)(5). If an aircraft is used predominantly outside the United States (determined under § 1.48–1(g)(1)), it must qualify under the provisions of section 48(a)(2)(B)(i) and § 1.48–1(g)(2)(i). If a vessel is used predominantly outside the United States, it must qualify under the provisions of section 48(a)(2)(B)(iii) and § 1.48–1(g)(2)(iii). The aircraft or vessel may not be suspension or termination period property described in section 48(h) or section 49(a) (as in effect before the enactment of the Revenue Act of 1978). See paragraph (g) (3) and (4) of this section for rules which apply if the property ceases to be section 38 property.

(2) *United States manufacture or construction.* An election under this section may be made only if the aircraft or vessel is manufactured or constructed in the United States. The aircraft or vessel will be considered to be manufactured or constructed in the United States if 50 percent or more of the basis of the aircraft or vessel is attributable to value added within the United States.

(3) *Exclusion of certain property used outside the United States.* The term ''aircraft or vessel'' as used in this paragraph (b) does not include any property which is used predominantly outside the United States and which qualifies as section 38 property under—

(i) Section 48(a)(2)(B)(v), relating to containers used in the transportation of property to and from the United States,

(ii) Section 48(a)(2)(B)(vi), relating to certain property used for the purpose of exploring for, developing, removing, or transporting resources from the Outer Continental Shelf, or