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connected with the conduct of a trade or business in a possession.

(7) *Indirect ownership.* The rules of section 318(a)(2) will apply except that the language “5 percent” will 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 U.S. Virgin Islands—

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

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

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

Example. X is a corporation organized under the law of the U.S. Virgin Islands 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 U.S. Virgin Islands 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 U.S. Virgin Islands. Seventy-four percent of the stock of X is owned by unrelated individuals who are residents of the United States or the U.S. Virgin Islands. 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/applicability dates.* Except as otherwise provided in this paragraph (i), this section applies to payments made in taxable years ending after April 9, 2008. If, on or after April 9, 2008, there takes effect an increase in the Commonwealth of Puerto Rico’s withholding tax 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, the rules of paragraphs (b)(2) and (e) of this sec-

tion will not apply to dividends received on or after the effective date of the increase. Paragraph (f)(4) of this section applies to payments made after January 31, 2006. Taxpayers may choose to apply paragraph (f)(4) of this section to payments made after October 22, 2004.

[T.D. 9248, 71 FR 5001, Jan. 31, 2006, as amended by T.D. 9391, 73 FR 19359, Apr. 9, 2008; 73 FR 27728, May 14, 2008]

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[T.D. 8658, 61 FR 9329, Mar. 8, 1996; 61 FR 15891, Apr. 10, 1996, as amended by T.D. 9281, 71 FR 47448, Aug. 17, 2006; T.D. 9465, 74 FR 49317, Sept. 28, 2009]