on which a decision of the Tax Court becomes final, see section 7481 and the regulations thereunder. Jeopardy under this paragraph (c)(1) means conditions exist that would require an assessment under section 6851 or 6861 and the regulations thereunder.

(2) *Suspension of the running of the period of limitations*— (i) *Relief under § 1.6015–2 or 1.6015–3.* The running of the period of limitations in section 6502 on collection against the requesting spouse of the assessment to which an election under § 1.6015–2 or § 1.6015–3 relates is suspended for the period during which the Commissioner is prohibited by paragraph (c)(1) of this section from collecting by levy or a proceeding in court and for 60 days thereafter.

(ii) *Relief under § 1.6015–4.* If a requesting spouse seeks only equitable relief under § 1.6015–4, the restrictions on collection of paragraph (c)(1) of this section do not apply. The request for relief does not suspend the running of the period of limitations on collection.

(3) *Definitions*—(i) *Levy.* For purposes of this paragraph (c), levy means an administrative levy or seizure described by section 6331.

(ii) *Proceedings in court.* For purposes of this paragraph (c), proceedings in court means suits filed by the United States for the collection of Federal tax. Proceedings in court does not refer to the filing of pleadings and claims and other participation by the Commissioner or the United States in suits not filed by the United States, including Tax Court cases, refund suits, and bankruptcy cases.

(iii) *Assessment to which the election relates.* For purposes of this paragraph (c), the assessment to which the election relates is the entire assessment of the deficiency to which the election relates, even if the election is made with respect to only part of that deficiency.

§ 1.6015–8 Applicable liabilities.

(a) *In general.* Sections 6015(b), 6015(c), and 6015(f) apply to liabilities that arise after July 22, 1998, and to liabilities that arose prior to July 22, 1998, that were not paid on or before July 22, 1998.

(b) *Liabilities paid on or before July 22, 1998.* A requesting spouse seeking relief from joint and several liability for amounts paid on or before July 22, 1998, must request relief under section 6013(e) and the regulations thereunder.

(c) *Examples.* The following examples illustrate the rules of this section:

Example 1. H and W file a joint income tax return for 1995 on April 15, 1996. There is an understatement on the return attributable to an omission of H's wage income. On October 15, 1998, H and W receive a 30-day letter proposing a deficiency on the 1995 joint return. W pays the outstanding liability in full on November 30, 1998. In March 1999, W files Form 8857, requesting relief from joint and several liability under section 6015(b). Although W's liability arose prior to July 22, 1998, it was unpaid as of that date. Therefore, section 6015 is applicable.

Example 2. H and W file their 1995 joint income tax return on April 15, 1996. On October 14, 1997, a deficiency is assessed regarding a disallowed business expense deduction attributable to H. On June 30, 1998, the Internal Revenue Service levies on W's bank account in full satisfaction of the outstanding liability. On August 31, 1998, W files a request for relief from joint and several liability. The liability arose prior to July 22, 1998, and it was paid as of July 22, 1998. Therefore, section 6015 is not applicable and section 6013(e) is applicable.

§ 1.6015–9 Effective date.

Sections 1.6015–0 through 1.6015–9 are applicable for all elections under § 1.6015–2 or § 1.6015–3 or any request for relief under § 1.6015–4 filed on or after federal regulations are published in the **Federal Register**.

Charles Rossotti,

Commissioner of Internal Revenue.

[FR Doc. 01–8 Filed 1–16–01; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–106030–98]

RIN 1545–AW50

Source of Income from Certain Space and Ocean Activities; Also, Source of Communications Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under section 863(d) governing the source of income from certain space and ocean activities. It also contains proposed regulations under sections 863(a), (d), and (e) governing the source of income from certain communications activity. This document also contains proposed regulations under sections 863(a) and (b), amending the regulations in § 1.863–3 to conform those regulations with these proposed regulations. This document affects persons who conduct activities in space, or on or under water not within the jurisdiction of a foreign country, possession of the United States, or the United States (collectively, in international water). This document also affects persons who derive income from transmission of communications. In addition, this document provides notice of a public hearing on these proposed regulations.

DATES: Comments and outlines of oral comments to be presented at the public hearing scheduled for March 28, 2001, at 10 a.m. must be received by March 7, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (Reg–106030–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–106030–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in the auditorium, seventh floor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Anne Shelburne, (202) 874–1490; concerning submissions and the hearing, and/or to be placed on the building access list to attend the hearing, La Nita Van Dyke, (202) 622–7180 (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 (OMB) 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 Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by March 19, 2001. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 services to provide information.

The collection of information requirements are in proposed § 1.863–8(g) and in § 1.863–9(g). This information is required by the IRS to monitor compliance with the federal tax rules for determining the source of income from space or ocean activities, or from transmission of communications. The likely respondents are taxpayers who conduct space or ocean activities, or who derive communications income. Responses to this collection of information are required to properly determine the source of a taxpayer's income from such transactions.

Books or 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.

Estimated total annual reporting/recordkeeping burden: 1,200 hours. The estimated annual burden per respondent varies from 3 hours to 7 hours, depending on individual circumstances, with an estimated average of 5 hours.

Estimated number of respondents: 250.

Estimated annual frequency of responses: One time per year.

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 assigned by the Office of Management and Budget.

Background

This document contains proposed regulations relating to the Income Tax Regulations (CFR part 1) under sections 863(a), (b), (d), and (e) of the Internal Revenue Code (Code). Congress enacted section 863(d) and section 863(e) as part of the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2085) (the 1986 Act). Section 863(d) governs the source of income derived from certain space and ocean activities. Section 863(e) governs the source of income derived from international communications activity.

Explanation of Provisions

These proposed regulations provide two sets of rules, one in § 1.863–8 for determining the source of income from space and ocean activities, the other in § 1.863-9 for determining the source of income from communications activity. Section 1.863–9 provides rules for both international communications income (ICI) and other communications income. The IRS and Treasury believe it is appropriate to provide source rules for both ICI and other communications income in a single regulation.

The IRS and Treasury are fully aware of the rapid technological evolution in the space and communications industries since Congress enacted sections 863(d) and (e) in 1986, and have attempted to take into account these changes as well as changes in the space and communications industries and business practices and business models. The IRS and Treasury recognize that these regulations address important issues for many different industries and have worked closely with the industries in drafting these rules. The IRS and Treasury are interested in receiving comments from these industries on how to accommodate issues arising from the use of new technologies, consistent with the language and purpose of the statutory provisions.

A. Space and Ocean Activity Under Section 863(d)

1. Scope of § 1.863–8 of the Proposed Regulations

Section 1.863–8 of the proposed regulations provides rules for sourcing income derived from space and ocean activity, notwithstanding other sections. Proposed regulations § 1.863–8(a) provides that a taxpayer derives income from a space or ocean activity only if the taxpayer conducts such activity directly. This is consistent with the approach that IRS and Treasury adopted in the § 1.863–3 regulations sourcing income from inventory sales.

2. Source of Gross Income From Space or Ocean Activity

a. *General.* Section 863(d)(1) states that, except as provided in regulations, any income derived from space or ocean activity by a U.S. person will be U.S. source income, and if derived by a foreign person, foreign source income. Proposed regulations § 1.863-8(b)(1) provides that a U.S. person's space or ocean income is U.S. source. Proposed regulations § 1.863–8(b)(1) also states the general rule that income derived by a foreign person from a space or ocean activity is foreign source income. However, the proposed regulations contain several exceptions to that general rule.

Proposed regulations § 1.863–8(b)(2) provides that if a foreign corporation is 50 percent or more owned by vote or value (directly, indirectly, or constructively) by U.S. persons and is not a controlled foreign corporation within the meaning of section 957 (CFC), all income derived by the corporation from space or ocean activity is U.S. source income. This rule reflects IRS and Treasury's concern that U.S. persons may use a foreign corporation (for example, by incorporating a 50/50 joint venture with a foreign person, thereby avoiding CFC status) to obtain results that are inconsistent with the purposes of this section. The IRS and Treasury believe Congress granted Treasury broad regulatory authority in section 863(d) to prevent taxpayers from circumventing the purposes of this section.

Proposed regulations § 1.863–8(b)(3) provides that if a foreign person is engaged in a U.S. trade or business, the foreign person's income derived from a space or ocean activity is presumed to be U.S. source income. The rule reflects IRS and Treasury's concern that a foreign person could engage in significant economic activities in the United States and avoid U.S. taxation of space or ocean income derived from such activities. For example, a foreign satellite company established in a no-tax jurisdiction could engage in substantial activity in the United States through launch facilities, yet pay no U.S. or foreign tax on income arising from leasing the satellites it launches. The IRS and Treasury believe Congress intended that a foreign person engaged in substantial U.S. business in the United States be subject to U.S. tax on related space or ocean activity.

The IRS and Treasury recognize that the presumption may be over-inclusive in certain cases. Therefore, the proposed regulations provide that if the foreign person can allocate gross space or ocean income between income from sources within the United States, space, or international water, and outside the United States and space and international water, to the satisfaction of the Commissioner, based on the facts and circumstances, which may include functions performed, resources employed, risks assumed, or other contributions to value, income from outside the United States and space and international water will be treated as foreign source income. When a foreign person is entitled to the benefits of a tax

treaty with the United States, such person may elect to be taxed under the rules of that treaty, so that, for example, the United States would tax only income attributable to a permanent establishment of that foreign person, regardless of the amount of income considered effectively connected with a U.S. trade or business.

b. *Source Rules for Sales of Certain Property.* Taxpayers must apply the rules of section 863(d) and these proposed regulations to determine the source of income from sales of property purchased or produced by the taxpayer, either when production occurs in whole or in part in space or in international water, or when the sale occurs in space or in international water. The rules of sections 861, 862, 863(a) and (b), and 865, and the regulations thereunder apply only to the extent provided in proposed regulations § 1.863–8(b)(4).

Proposed regulations § 1.863–8(b)(4)(i) provides that income derived from the sale of purchased property in space or international water is sourced under paragraph (b)(1), (2), or (3) of this section. Proposed regulations § 1.863–8(d)(2)(iii) provides that a sale occurs in space or international water if either property is located in space or international water at the time the rights, title, and interests pass to the purchaser, or the property sold is for use in space or international water. This rule for determining if a sale takes place in space or in international water modifies for space and ocean activity the rule in § 1.861–7(c) for otherwise determining where a sale takes place. The IRS and Treasury believe this rule for determining the place of sale in the case of space or ocean activity is consistent with the legislative history of section 863(d), indicating Congress intended that space and ocean activity be broadly defined. See S. Rept. No. 313, 99th Cong., 2d Sess. 357 (1986) (Senate Report). It is also consistent with the language of the Senate Report stating that the committee did not intend to override the title passage rule for sales of property on the high seas. Consistent with this language, proposed regulations § 1.863–8(d)(1)(ii) excludes from the definition of ocean activity the sale of inventory on international water, and the source of income from such sales continues to be determined under § 1.861–7(c).

Proposed regulations § 1.863–8(b)(4)(ii) provides rules for income derived from the sale of property produced by the taxpayer. To determine the source of income derived from the sale of property produced by the taxpayer, proposed regulations § 1.863–8(b)(4)(ii)(A) provides that the taxpayer must divide gross income from such sale equally between production activity and sales activity. Thus, one-half of the taxpayer's gross income is attributed to production activity, and the other one-half of such gross income is attributed to sales activity.

Proposed regulations § 1.863–8(b)(4)(ii)(A) provides that income attributable to sales activity is sourced applying the rules applicable to the sale of purchased property. If the taxpayer sells such property in space or international water, the source of income attributable to sales activity is determined under paragraph (b)(1), (2), or (3). If the taxpayer sells such property outside space and outside international water, the source of income attributable to sales activity is determined under § 1.863–3(c)(2). Proposed regulations § 1.863–8(b)(4)(ii)(B) provides that income attributable to production activity, when production occurs only in space or in international water, is sourced under paragraphs (b)(1), (2), or (3). When production occurs only outside space and international water, income attributable to production activity is sourced under § 1.863-3(c)(1). When production activity occurs both in space or in international water and outside space and international water, proposed regulations § 1.863–8(b)(4)(ii)(C) splits the income attributed to production activity between production activities occurring in space or in international water, and production activities occurring outside space and international water. Gross income must be allocated to the satisfaction of the Commissioner, based on all relevant facts and circumstances, which may include functions performed, resources employed, risks assumed, and any other contributions to the value of the property. The source of gross income attributable to production activities in space or in international water is sourced under paragraphs (b)(1), (2), or (3). The source of gross income attributable to production activities outside space and international water is determined under § 1.863–3(c)(1).

c. *Special Rule for Determining the Source of Income from Services.* Proposed regulations § 1.863–8(b)(5) provides that income derived from the performance of services in space or in international water is sourced under paragraph (b)(1), (2), or (3). Proposed regulations § 1.863–8(d)(2)(ii)(A) provides that a performance of a service is a space or ocean activity when a part of the service, even if de minimis, is performed in space or in international water. The IRS and Treasury believe that Congress intended a broad range of activities be treated as space or ocean activities.

The IRS and Treasury recognize that this rule may be over-inclusive in certain cases. Therefore, proposed regulations § 1.863–8(b)(5) provides that the taxpayer can allocate gross income derived from the performance of the service between activities that occur in space or international water and activities that occur outside space and international water, to the satisfaction of the Commissioner, based on facts and circumstances, which may include functions performed, resources employed, risks assumed, or other contributions to value. Gross income allocated to activities occurring outside space and international water will be sourced under sections 861, 862, 863, and 865 of the Code.

d. *Special Rule for Determining the Source of Communications Income.* A communications activity, as defined in proposed regulations § 1.863–9(d), also can be a space or ocean activity. Pursuant to the authority granted in section 863(d)(1), proposed regulations § 1.863–8(b)(6) provides that income from communications activity that is also a space or ocean activity is sourced under proposed regulations § 1.863–9(b).

3. Taxable Income

When a taxpayer allocates gross income under paragraph (b)(3) (allocation for certain foreign persons), paragraph (b)(4)(ii)(C) (allocation between production occurring in space or international water and production occurring outside), or paragraph (b)(5) (allocation between services occurring in space or international water and those occurring outside) of this section, the taxpayer must allocate or apportion expenses, losses, and other deductions under §§ 1.861–8 through 1.861–14T of the regulations to the class of gross income, which must include the total income so allocated in each case. A taxpayer must then apply the rules of §§ 1.861–8 through 1.861–14T to properly allocate or apportion amounts of expenses, losses, and other deductions allocated or apportioned to such class of gross income between gross income from sources within the United States and without the United States.

When a taxpayer must allocate gross income to the satisfaction of the Commissioner based on the facts and circumstances, IRS and Treasury believe that such allocations would be based generally on section 482 principles. However, IRS and Treasury solicit comments on this approach, including specific comments and examples on

alternative methods that could be used to make these allocations.

4. *Definition of Space and Ocean Activity*

a. *General Rules.* Section 863(d)(2) provides that space or ocean activity means any activity conducted in space, and any activity conducted in or under water not within the jurisdiction of the United States or a foreign country. Proposed regulations § 1.863–8(d)(1)(i) defines space as any area not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States, and not in international water.

Proposed regulations § 1.863–8(d)(1)(i) provides that space activity is any activity conducted in space, with certain exceptions. Space activity includes performance and provision of services in space, leasing of equipment or other property, including spacecraft (e.g., satellites) or transponders, located in space, licensing of technology or other intangibles for use in space, and the production, processing, or creation of property in space. Space activity includes the sale of property in space. Space activity also includes underwriting income from the insurance of risks on activities that produce income derived from space activity. The inclusion of such underwriting income is consistent with language in the Senate Report. See Senate Report at 357.

Proposed regulations § 1.863–8(d)(1)(ii) provides that ocean activity is any activity conducted in international water, with certain exceptions. Ocean activity includes performance and provision of services in international water, leasing of equipment or other property located in international water, licensing of technology or other intangibles for use in international water, and the production, processing, or creation of property in international water. Ocean activity includes the sale of property in international water, and the sale of inventory under international water, but does not include the selling of inventory if the sale takes place on international water. Thus, if property sold on international water is inventory property, income attributable to sales activity is sourced under § 1.861–7(c).

Ocean activity also includes underwriting income from the insurance of risks on activities that produce income derived from ocean activity. The inclusion of such underwriting income is consistent with language in the Senate Report. See Senate Report at 357.

Ocean activity also includes any activity performed in Antarctica. Ocean activity further includes the leasing of a vessel if such vessel does not transport cargo or persons for hire between ports-of-call. Thus, for example, income earned by a lessor of a vessel that is to engage only in research activities in international water is ocean income. Ocean activity also includes the leasing of drilling rigs, extraction of minerals, and performance and provision of services related thereto, to the extent the mines, oil and gas wells, or other natural deposits are not within the jurisdiction of the United States, U.S. possessions, or any foreign country (as defined in section 638).

Based on legislative history, the IRS and Treasury believe space and ocean activity should be broadly defined based on legislative history. The legislative history clearly indicates that Congress intended to characterize certain land based activity as space or ocean activity. See Senate Report at 357. Consistent with that determination, the proposed regulations provide that when activities occur both in space or in international water and outside space and international water, and constitute parts of a single transaction described in § 1.863–8(d)(1), the transaction will be characterized as space or ocean activity. Thus, for example, income from the lease of equipment located in space will be sourced in its entirety under section 863(d), even though certain functions associated with the transaction may be performed outside space and international water. The rules of this section for defining space or ocean activity by combining activities occurring both in space or in international water and outside space and international water simply reflect existing principles for characterizing a transaction, and are fully consistent with rules for characterizing income for purposes of other source rules. Taxpayers enjoy flexibility in structuring their transactions that will be characterized under existing principles. To ensure the statutory purpose is not circumvented, the Commissioner may treat parts of a transaction as separate transactions, or combine separate transactions as a single transaction.

Certain activities occurring in space or international water are not considered either space or ocean activity. Proposed regulations § 1.863–8(d)(3)(i) provides that space or ocean activity does not include any activity giving rise to transportation income as defined in section 863(c). Proposed regulations § 1.863–8(d)(3)(ii) provides that space or ocean activity also does not include any activity with respect to mines, oil and gas wells, or other natural deposits to the extent the mines or wells are located within the jurisdiction (as recognized by the United States) of any country, including the United States and its possessions (as defined in section 638). Proposed regulations § 1.863–8(d)(3)(iii) provides that space or ocean activity does not include any activity giving rise to international communications income as defined in proposed regulations § 1.863–9(d)(3)(ii). These exceptions are consistent with section 863(d)(2)(B) of the Code.

b. *Special Rules in Determining Space or Ocean Activity.* Proposed regulations § 1.863–8(d)(2)(ii)(A) provides that services are performed in space or in international water if functions are performed, resources employed, risks assumed, or other contributions to the value of the transaction occur in space or international water, whether such contributions are performed by personnel, or equipment, or otherwise. The IRS and Treasury believe that all contributions to a transaction's value, whether contributed by personnel, equipment, or otherwise, should be considered in determining whether services are performed in space or international water.

Proposed regulations § 1.863–8(d)(2)(ii)(A) provides that the performance of a service is treated as a space or ocean activity if a part of the service is performed in space or international water. The IRS and Treasury recognize that this rule may be over-inclusive in certain cases. Therefore, proposed regulations § 1.863–8(d)(2)(ii)(B) provides that the performance of a service will not be a space or ocean activity if the only activity of the taxpayer in space or in international water is to facilitate the taxpayer's own communications, as part of provision or delivery of a service by the taxpayer, and that service would not otherwise be in whole or in part a space or ocean activity. Several examples in the regulations illustrate this facilitation exception. The IRS and Treasury recognize that taxpayers may use communications services in conducting a business, and the fact that such communications may be routed through space or international water instead of by way of land should not produce differences in the source of the taxpayer's income derived from such service.

5. Treatment of Partnerships

Proposed regulations § 1.863–8(e) provides that for U.S. partnerships, section 863(d) and the regulations thereunder will be applied at the partnership level. The IRS and Treasury believe this rule is consistent with

section 7701(a)(30)(B), which defines a U.S. person as a domestic partnership. For foreign partnerships, section 863(d) and the regulations thereunder will be applied at the partner level. The proposed regulations provide a different rule for foreign partnerships because IRS and Treasury are concerned that U.S. persons may use a foreign partnership to circumvent the purposes of this section. For example, two U.S. persons by the simple expediency of forming a foreign partnership can change significantly the U.S. tax consequences under section 863(d).

6. Reporting and Documentation Requirements

When a taxpayer allocates gross income to the satisfaction of the Commissioner under § 1.863–8(b)(3) (income of certain foreign persons), § 1.863–8(b)(4)(ii)(C) (certain production activity), or under § 1.863–8(b)(5) (services) of the proposed regulations, the taxpayer must do so by making the allocation on a timely filed original return (including extensions). An amended return does not qualify, and section 9100 relief will not be available. In all cases, a taxpayer must maintain contemporaneous documentation regarding the allocation of gross income, and allocation of expenses, losses, and other deductions, the methodology used, and the circumstances justifying use of that methodology. The taxpayer must produce such documentation within 30 days upon request.

B. Communications Activity Under Sections 863(a), (d), and (e)

1. Scope

Section 1.863–9 of the proposed regulations provides rules for sourcing income derived from communications activity, notwithstanding any other section. Pursuant to proposed regulations § 1.863–8, these source rules apply to communications activity that is also space or ocean activity.

2. Source of Gross Income Derived From Communications Activity

a. *International Communications Income.* Section 863(e)(1)(A) states that any international communications income of a U.S. person will be sourced 50 percent to the United States and 50 percent to foreign sources. Proposed regulations § 1.863–9(b)(2)(i) provides that international communications income of a U.S. person will be sourced 50 percent to the United States and 50 percent to foreign sources.

Section 863(e)(1)(B)(i) provides that any international communications income of a foreign person will be foreign source income except as provided in regulations or in section 863(e)(1)(B)(ii). Proposed regulations § 1.863–9(b)(2)(ii)(A) states the general rule that international communications income of a foreign person is foreign source income. However, the proposed regulations contain several exceptions to the general rule.

Proposed regulations § 1.863–9(b)(2)(ii)(B) states that if a foreign corporation is 50 percent or more owned by vote or value (directly, indirectly, or constructively) by U.S. persons, or is a controlled foreign corporation within the meaning of section 957, all international communications income is U.S. source income. This rule reflects IRS and Treasury's concern that U.S. persons may use a foreign corporation to obtain benefits that are inconsistent with the purposes of this section.

Section 863(e)(1)(B)(ii) provides that if a foreign person has a U.S. fixed place of business, international communications income attributable to the fixed place of business is U.S. source income. Consistent with section 863(e)(1)(B)(ii), proposed regulations § 1.863–9(b)(2)(ii)(C) states that if a foreign person, other than a foreign person described in paragraph (b)(2)(ii)(A), maintains an office or other fixed place of business in the United States, any international communications income attributable to the office or other fixed place of business is U.S. source income. The principles of section 864(c)(5) will apply to determine whether a foreign person has an office or fixed place of business in the United States. This rule does not apply if the foreign person is engaged in a U.S. trade or business.

Proposed regulations § 1.863–9(b)(2)(ii)(D) provides that if a foreign person is engaged in a U.S. trade or business, the foreign person's international communications income is presumed to be U.S. source income. The rule reflects IRS and Treasury's concern that a foreign person could avoid a U.S. fixed place of business under section 863(e)(1)(B)(ii), yet engage in significant communications activity in the United States.

The IRS and Treasury believe Congress intended that a foreign person engaged in substantial U.S. business in the United States be subject to U.S. tax on that communications activity.

The IRS and Treasury recognize that this rule may be over-inclusive in certain cases. Therefore, the proposed regulations provide that if the foreign person can allocate income to international communications activity outside the United States and space and international water, to the satisfaction of the Commissioner, based on the facts and circumstances, which may include functions performed, resources employed, risks assumed, or other contributions to value, then the income allocated to such communications activity outside the United States and space and international water will be foreign source income. When a foreign person is entitled to the benefits of a tax treaty with the United States, such person may elect to be taxed under the rules of that treaty, so that, for example, the United States would tax only income attributable to a permanent establishment of that foreign person, regardless of the amount of income considered effectively connected with a U.S. trade or business.

b. *Other Communications Income.* The proposed regulations also provide rules, for both U.S. and foreign persons, for determining the source of income from communications activity that does not qualify as international communications activity. The IRS and Treasury believe rules that address income from other communications activities are necessary based on the legislative history. See Senate Report at 357.

Proposed regulations § 1.863–9(b)(3) states that the source of income derived by either a U.S. or foreign person from U.S. communications activity is U.S. source income. Proposed regulations § 1.863–9(b)(4) states that the source of income derived by either a U.S. or foreign person from foreign communications activity is foreign source income. Proposed regulations § 1.863–9(b)(5) states that the source of income derived from space/ocean communications activity is determined under section 863(d) and the regulations thereunder.

3. Taxable Income

When a taxpayer allocates gross income under paragraph (b)(2)(ii)(D) (certain foreign persons), or (d)(1)(ii) (determining a communications activity), the taxpayer must allocate or apportion expenses, losses, and other deductions as prescribed in §§ 1.861–8 through 1.861–14T of the regulations to the class of gross income, which must include the total income so allocated in each case. A taxpayer must then apply the rules of §§ 1.861–8 through 1.861–14T of the regulations to properly allocate or apportion amounts of expenses, losses, and other deductions allocated or apportioned to such gross income between gross income from sources within the United States and without the United States. For amounts of expenses, losses, and other

deductions allocated or apportioned to gross income derived from international communications activity, when the source of income is determined under the 50/50 method of paragraph (b)(2)(i), taxpayers must apportion expenses and other deductions between U.S. and foreign sources pro rata based on the relative amounts of U.S. and foreign source gross income. Research and experimental expenditures qualifying under § 1.861–17 are allocated under that section.

When a taxpayer must allocate gross income to the satisfaction of the Commissioner based on the facts and circumstances, IRS and Treasury believe that such allocations would be based generally on section 482 principles. However, IRS and Treasury solicit comments on this approach, including specific comments and examples on alternative methods that could be used to make these allocations.

4. Definition of Communications Activity and Income Derived From Communications Activity

a. *Communications Activity.* Proposed regulations § 1.863–9(d)(1) defines a communications activity as an activity consisting solely in the delivery by transmission of communications or data (communications). The definition of a communications activity is limited to the function of transmitting a particular communication from point A to point B. The delivery of communications by means other than transmission, for example, delivery of a letter is not a communications activity. The IRS and Treasury believe that this narrow definition of communications activity is consistent with the legislative history of section 863(e). See Senate Report at 357.

The provision of capacity to transmit communications or data is considered to be a communications activity. For example, the provision of satellite transponder capacity can qualify as a communications activity.

The provision of content or any other additional service will not be treated as a communications activity unless de minimis. For example, changes in the form of a voice communication when switching from analog technology to digital data for Internet telephony would be disregarded in determining whether there has been a transmission of communications within the meaning of proposed regulations § 1.863–9(d). However, payment for information from a data base sent electronically, or for income attributable to an entertainment event transmitted electronically, would not be income derived from a communications activity.

When the provision of content or any other services is de minimis, such content or services are ignored, and the transaction will be treated solely as the transmission of communications within the meaning of proposed regulations § 1.863–9(d)(1). The determination of whether the provision of content or other services is de minimis should be based on all the facts and circumstances. The IRS and Treasury believe the exclusion of content and other services is consistent with the legislative history of section 863(e). No evidence exists in the Congressional testimony or in the legislative history that content provided by transmission was to be considered a communications activity.

Proposed regulations § 1.863–9(d)(1)(ii) requires that a transaction encompassing non-de minimis communications activities and non-de minimis non-communications activities must be broken into parts and each part treated as a separate transaction. Proposed regulations § 1.863–9(d)(1)(ii) states that gross income derived from the activities must be allocated to each separate transaction, to the satisfaction of the Commissioner, based on all relevant facts and circumstances, which may include functions performed, resources employed, risks assumed, and any other contributions to the value of the respective transactions. For example, a payment by an advertiser to a TV broadcast station may be in part a payment for transmission of the advertisement, but could also be a payment for other property or services, for example the transmitter's ability to reach a particular market or audience. Such activities, if not de minimis, must be treated as non-communications activities under § 1.863–9(d)(1)(ii) of the proposed regulations.

To ensure the statutory purposes are not circumvented, the Commissioner may treat parts of a transaction as separate transactions, or construe separate transactions as a single transaction.

b. *Income Derived from Communications Activity.* Income derived from communications activity is defined in proposed regulations § 1.863–9(d)(2) as income derived from the transmission of communications, including income derived from the provision of capacity to transmit communications. There is no requirement that the income recipient perform the transmission function. This rule reflects IRS and Treasury's understanding that those providing communications services often use capacity owned or operated by others. However, income is derived from communications activity only if the taxpayer is paid to transmit, and bears the risk of transmitting, the communications.

c. *Character of Communications Activity.* Proposed regulations § 1.863–9(d)(3) provides rules for characterizing income derived from a communications activity for purposes of sourcing the income derived from such activity. The character of income derived from communications activity is determined by establishing the two points between which the taxpayer is paid to transmit, and bears the risk of transmitting, the communication. Under the paid-to-do rule, the path the communication takes between the two points is not relevant in determining the character of the transmission. If a taxpayer is paid to take a communication from one point to another point, income derived from the transmission is characterized based on the transmission between those two points, even though the taxpayer contracts out part of the transmission to another. This rule reflects IRS and Treasury's recognition that those providing communications often use the network owned or operated by others. Several examples in the proposed regulations illustrate the paid-to-do rule.

Proposed regulations § 1.863–9(d)(3)(ii) defines income derived from international communications activity as the transmission from a point in the United States and a point in a foreign country (or a possession of the United States). Proposed regulations § 1.863–9(d)(3)(iii) defines income derived from U.S. communications activity as the transmission between two points in the United States or a point in the United States and a point in space or international water.

Proposed regulations § 1.863–9(d)(3)(iv) defines income derived from foreign communications activity as the transmission between two points either in a foreign country or in foreign countries or a point in a foreign country and a point in space or international water. Proposed regulations § 1.863–9(d)(3)(v) defines income derived from space/ocean communications activity as the transmission between a point in space or international water and another point in space or international water. The IRS and Treasury believe these rules are consistent with the legislative history. See Senate Report at 357.

When the taxpayer cannot establish the two points between which the taxpayer is paid to transmit, the source of income derived from such activity, for either a U.S. or foreign person, is U.S. source income. Thus, for example, when a provider of communications services provides both local and

international long distance along with cable services in one-price bundles for a set amount each month, tracing each transmission may not be possible or practical. In such cases, the source of income derived from communications activity is U.S. source income. The IRS and Treasury understand that many in the communications industry may not consider it practical or possible to prove the end points of the communications the taxpayer transmits. The IRS and Treasury solicit comments as to proposals for those situations when taxpayers cannot establish the points between which the taxpayer is paid to transmit the communications.

5. Treatment of Partnerships

Proposed regulations § 1.863–9(e) provides, in general, that for U.S. partnerships, section 863(e) and the regulations thereunder will be applied at the partnership level. The IRS and Treasury believe this rule is consistent with section 7701(a)(30)(B), which defines a U.S. person as a domestic partnership. For foreign partnerships, and in the case of a U.S. partnership in which 50 percent or more of the partnership interests are owned by foreign persons, section 863(e) and the regulations thereunder will be applied at the partner level. The proposed regulations provide a different rule for foreign partnerships and for U.S. partnerships with substantial foreign ownership because the IRS and Treasury are concerned that U.S. persons may use such partnerships to circumvent the purposes of this section.

6. Reporting Rules and Documentation Requirements

When a taxpayer allocates gross income to the satisfaction of the Commissioner under proposed regulations § 1.863–9(b)(2)(ii)(D) (certain foreign persons) or -(d)(1)(ii) (determining a communications activity), it does so by making the allocation on a timely filed original return (including extensions). An amended return does not qualify, and section 9100 relief will not be available. In all cases, a taxpayer must maintain contemporaneous documentation regarding the allocation of gross income, and allocation of expenses, losses and other deductions, the methodology used, and the circumstances justifying use of that methodology. The taxpayer must produce such documentation within 30 days upon request.

C. Amendment to the § 1.863–3 Regulations

These proposed regulations amend the regulations under § 1.863–3 for determining the source of income in certain inventory sales.

The regulations provide that in determining the source of income from sales of property when the property is either (i) produced in whole or in part in space or in international water, or (ii) sold in space or in international water, the rules of § 1.863–8 of the proposed regulations apply. The rules of sections 863 (a) and (b), and the regulations under those sections, do not apply to determine the source of income in such cases, except to the extent provided in § 1.863–8 of the proposed regulations. The proposed regulations in § 1.863–8(b)(4)(ii)(A) provide, however, that the source of income from sales of inventory on international water continues to be sourced under § 1.863–3(c)(2). The regulations in § 1.863–3(a)(1) and –3(c)(1)(i)(A) are amended to reflect these provisions.

The proposed regulations also amend § 1.863–3(c)(2) to provide that the place of sale will be presumed to be the United States, for purposes of that section, when property is produced in the United States and the property is sold to a U.S. resident for use, consumption, or disposition in space. See § 1.864–6(b)(3) for determining whether property is used in space and whether the sale is to a U.S. resident.

These rules reflect the views of Treasury and the IRS that sales of satellites or transponders by a U.S. resident in space should produce U.S. source income. These rules also reflect the view that sales of such property by a U.S. resident to a U.S. purchaser should produce U.S. source income. Treasury and the IRS believe that these provisions are consistent with Congress' intent in enacting section 863(d) to tax U.S. persons on a residency basis on income that is not likely to be subject to foreign tax by a foreign country. It is also consistent with the tax policy of the foreign tax credit that income not likely to be subject to foreign tax should not be treated as foreign source income, which would inappropriately allow taxpayers with excess foreign tax credits to shelter this income from U.S. tax.

Proposed Effective Dates

These regulations are proposed to apply for taxable years beginning on or after the date that is 30 days after the date of publication of final regulations in the **Federal Register**.

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 is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the rules of this section principally impact large multinationals who pay foreign taxes on substantial foreign operations and therefore the rules will impact very few small entities. Moreover, in those few instances where the rules of this section impact small entities, the economic impact on such entities is not likely to be significant. Accordingly, a regulatory flexibility analysis is not required. 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 comments that are submitted timely (in the manner described under the **ADDRESSES** caption) to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 28, 2001, at 10 a.m., in the auditorium, seventh floor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. 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 15 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 comments and an outline of topics to be discussed and the time to be devoted to each topic (in the manner described under the **ADDRESSES** caption of this preamble) by March 7, 2001.

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.

Drafting Information

The principal author of these regulations is Anne Shelburne, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 1.863–8 also issued under 26 U.S.C. 863(a), (b) and (d).

Section 1.863–9 also issued under 26 U.S.C. 863(a), (d) and (e). * * *

Par. 2 Section 1.863–3 is amended by:

1. Adding a sentence after the first sentence in paragraph (a)(1).

2. Adding a sentence at the end of paragraph (c)(1)(i)(A).

3. Adding three sentences, one after the current first sentence of paragraph (c)(2), and the other two sentences after the current second sentence of paragraph (c)(2).

The additions read as follows:

§ 1.863–3 Allocation and apportionment of income from certain sales of inventory.

(a) * * * (1) * * *To determine the source of income from sales of property produced by the taxpayer, when the property is either produced in whole or in part in space or on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States (in international water), or is sold in space or in international water, the rules of § 1.863–8 apply, and the rules of this section do not apply, except to the extent provided in § 1.863–8. * * *

* * * * *

(c) * * * (1) * * * (i) * * * (A) * * * For rules regarding the source of income when production takes place, in whole or in part, in space or in international water, the rules of § 1.863–8 apply, and the rules of this section do not apply except to the extent provided in § 1.863–8.

* * * * *

(c)(2) * * * Notwithstanding any other provision, for rules regarding the source of income when a sale takes place in space or in international water, the rules of § 1.863–8 apply, and the rules of this section do not apply except to the extent provided in § 1.863–8. * * * The place of sale will be presumed to be the United States under this rule when property is produced in the United States and the property is sold to a U.S. resident, who uses the property in space or in international water. In such cases, the property will be treated as sold for use, consumption, or disposition in the United States.

* * * * *

Par. 3 Section 1.863–8 and 1.863–9 are added to read as follows:

§ 1.863–8 Source of income from space and ocean activity under section 863(d).

(a) *In general.* Income of a U.S. or a foreign person derived from space or ocean activity (space or ocean income) is sourced under the rules of this section, notwithstanding any other provision, including sections 861, 862, 863, and 865. A taxpayer will not be considered to derive income from space or ocean activity, as defined in paragraph (d) of this section, if such activity is performed by another person, subject to the rules for the treatment of consolidated groups in section § 1.1502–13.

(b) *Source of gross income from space or ocean activity*—(1) *In general.* Income derived by a U.S. person from space or ocean activity is income from sources within the United States, except as otherwise provided in this paragraph (b). Income derived by a person other than a United States person from space or ocean activity is income from sources without the United States, except as otherwise provided in this paragraph (b).

(2) *Income derived by certain foreign corporations.* If a U.S. person or U.S. persons own 50 percent or more of the vote or value of the stock of a foreign corporation (directly, indirectly or constructively) that is not a controlled foreign corporation within the meaning of section 957, all income derived by that foreign corporation from space or ocean activity is U.S. source income.

(3) *Income derived by foreign persons engaged in a U.S. trade or business.* If a foreign person, other than a controlled foreign corporation within the meaning of section 957 or a foreign person described in paragraph (b)(2) of this section, is engaged in a U.S. trade or business, all income derived by that person from space or ocean activity is presumed to be U.S. source income. However, if the foreign person can allocate income between sources within the United States, or space, or international water, and sources outside the United States and space and international water, to the satisfaction of the Commissioner, based on the facts and circumstances, which may include functions performed, resources employed, risks assumed, or other contributions to value, then space or ocean income allocated to sources outside the United States and space and international water shall be treated as from sources outside the United States.

(4) *Source rules for income from certain sales of property*—(i) *Sales of purchased property.* When a taxpayer sells property in space or in international water, the source of gross income shall be determined under paragraph (b)(1), (2), or (3) of this section as applicable. However, if inventory, within the meaning of section 1221(1), is sold on international water, the source of income shall be determined under § 1.863–3(c)(2).

(ii) *Sales of property produced by the taxpayer*—(A) *General.* If the taxpayer both produces property and also sells such property, the taxpayer must divide gross income from such sales between production activity and sales activity under the 50/50 method as described in this paragraph (b)(4)(ii)(A). Under the 50/50 method, one-half of the taxpayer's gross income will be considered income attributable to production activity, and the source of that income will be determined under paragraphs (b)(4)(ii)(B) or (C) of this section. The remaining one-half of such gross income will be considered income attributable to sales activity and the source of that income will be determined under paragraph (b)(4)(i) of this section. However, if the taxpayer sells such property outside space and outside international water, the source of gross income attributable to sales activity will be determined under § 1.863–3(c)(2).

(B) *Production only in space or in international water, or only outside space and international water.* When production occurs only in space or in international water, income attributable to production activity is sourced under paragraph (b)(1), (2), or (3) of this section as space or ocean income. When production occurs only outside space and international water, income attributable to production activity is sourced under § 1.863–3(c)(1).

(C) *Production both in space or in international water and outside space and international water.* When property is produced in space or in international

water and outside space and international water, gross income must be allocated to production occurring in space or in international water and production occurring outside space and international water, to the satisfaction of the Commissioner, based on all the facts and circumstances, which may include functions performed, resources employed, risks assumed, and any other contributions to value. The source of gross income allocated to space or international water is determined under paragraph (b)(1), (2), or (3) of this section. The source of gross income allocated outside space and international water is determined under § 1.863–3(c)(1).

(5) *Special rule for determining the source of gross income from services.* If a transaction characterized as the performance of services constitutes a space or ocean activity by reason of the performance of part of the service in space or in international water, as determined under paragraph (d)(2)(ii)(A) of this section, the source of all gross income derived from such transaction of which such performance is a part is determined under paragraph (b)(1), (2), or (3) of this section. However, if the taxpayer can allocate gross income between performance occurring outside space and international water, and performance occurring in space or international water, to the satisfaction of the Commissioner, based on the facts and circumstances, including functions performed, resources employed, risks assumed, or other contributions to value, then the source of income allocated to performance occurring outside space and international water shall be determined under sections 861, 862, 863, and 865.

(6) *Special rule for determining source of income from communications activity (other than income from international communications activity).* Space and ocean activity, as defined in paragraphs (d)(1) and (2) of this section, includes activity occurring in space or in international water that is characterized as a communications activity as defined in § 1.863–9(d). The source of gross income from space or ocean activity that is also a communications activity as defined in § 1.863–9(d) is determined under the rules of § 1.863–9(b), rather than under paragraph (b) of this section.

(c) *Taxable income.* When a taxpayer allocates gross income under paragraph (b)(3), (b)(4)(ii)(C), or (b)(5) of this section, to the satisfaction of the Commissioner, based on all the facts and circumstances, the taxpayer must allocate or apportion expenses, losses, and other deductions as prescribed in §§ 1.861–8 through 1.861–14T to the class of gross income, which must include the total income so allocated in each case. A taxpayer must then apply the rules of §§ 1.861–8 through 1.861–14T to properly allocate or apportion amounts of expenses, losses, and other deductions allocated or apportioned to such gross income between gross income from sources within the United States and without the United States.

(d) *Space and Ocean activity*—(1) *Definition*—(i) *Space activity.* In general, space activity is any activity conducted in space. Space activity includes performance and provision of services in space, as defined in paragraph (d)(2)(ii)(A) of this section, leasing of equipment located in space, including spacecraft (e.g., satellites) or transponders located in space, licensing of technology or other intangibles for use in space, and the production, processing, or creation of property in space, as defined in paragraph (d)(2)(i) of this section. Space activity includes activity occurring in space that is characterized as communications activity (other than international communications activity) under § 1.863–9(d). Space activity also includes underwriting income from the insurance of risks on activities that produce space income. Space activity includes the sale in space of property, as defined in paragraph (d)(2)(iii) of this section. For purposes of this section, space means any area not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States, and not in international water. For purposes of determining space activity, the Commissioner may separate parts of a single transaction into separate transactions or combine separate transactions as parts of a single transaction. Paragraph (d)(3) of this section lists exceptions to the general rule.

(ii) *Ocean activity.* In general, ocean activity is any activity conducted on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States (collectively, in international water). Ocean activity includes performance and provision of services in international water, as defined in paragraph (d)(2)(ii)(A) of this section, leasing of equipment located in international water, including underwater cables, licensing of technology or other intangibles for use in international water, and the production, processing, or creation of property in international water, as defined in paragraph (d)(2)(i) of this section. Ocean activity includes sales of property in international water, as defined in paragraph (d)(2)(iii) of this section, but ocean activity does not include the selling of inventory as defined in section 1221(1) on international water. Ocean activity includes activity occurring in international water that is characterized as communications activity (other than international communications activity) under § 1.863–9(d). Ocean activity also includes underwriting income from the insurance of risks on activities that produce ocean income. Ocean activity also includes any activity performed in Antarctica. Ocean activity further includes the leasing of a vessel if such vessel does not transport cargo or persons for hire between ports-of-call. Thus, for example, the leasing of a vessel that is to engage only in research activities in international water is an ocean activity. Except as provided in paragraph (d)(3)(ii) of this section, ocean activity also includes the leasing of drilling rigs, extraction of minerals, and performance and provision of services related thereto. For purposes of determining ocean activity, the Commissioner may separate parts of a single transaction into separate transactions or combine separate transactions as parts of a single transaction. Paragraph (d)(3) of this section lists exceptions to the general rule.

(2) *Determining a space or ocean activity*—(i) *Production of property in space or in international water.* For purposes of this section, production activity means an activity that creates, fabricates, manufactures, extracts, processes, cures, or ages property within the meaning of sections 864(a) and § 1.864–1.

(ii) *Special rule for performance of services*—(A) *General.* If a transaction is characterized as the performance of a service, then such service will be treated as a space or ocean activity when a part of the service, even if de minimis, is performed in space or in international water. Services are performed in space or in international water if functions are performed, resources employed, risks assumed, or other contributions to value occur in space or in international water, regardless of whether performed by personnel, or equipment, or otherwise.

(B) *Exception to the general rule—facilitating the taxpayer's own communications.* If a taxpayer's only activity in space or in international water is to facilitate the taxpayer's own communications as part of the provision or delivery of a service provided by the taxpayer, and that service would not otherwise be in whole or in part a space

or ocean activity, such service will not be treated as either space or ocean activity because of such facilitation.

(iii) *Sale in space or in international water.* In applying § 1.861–7(c) to determine where a sale takes place, property will be sold in space or in international water if the property is located in space or in international water when rights, title and interest pass to the buyer (or when bare legal title is retained, at the time and place of passage of beneficial ownership and risk of loss), or if property is sold for use in space or in international water.

(3) *Exceptions to space or ocean activity.* Space or ocean activity does not include the following types of activities—

(i) Any activity giving rise to transportation income as defined in section 863(c); or

(ii) Any activity with respect to mines, oil and gas wells, or other natural deposits to the extent the mines or wells are located within the jurisdiction (as recognized by the United States) of any country, including the United States and its possessions; or

(iii) Any activity giving rise to international communications income as defined in § 1.863–9(d)(3)(ii).

(e) *Treatment of partnerships.* In the case of a U.S. partnership, this section will be applied at the partnership level. In the case of a foreign partnership, this section will be applied at the partner level.

(f) *Examples.* The following examples illustrate the rules of this section:

Example 1. Space activity—activity occurring on land and in space. (i) *Facts.* S owns satellites, and leases one of its satellites to A. S, as lessor, will not operate the satellite. Part of S's performance as lessor in this transaction occurs on land.

(ii) *Analysis.* The combination of S's activities is characterized as the lease of equipment. Since the equipment is located in space, the transaction is defined as space activity under paragraph (d)(1)(i) of this section. Income derived from the lease will be sourced in its entirety under paragraph (b) of this section.

Example 2. Space activity. (i) *Facts.* X is an Internet service provider, offering a service to personal computer users accessing the Internet. This service permits a customer, C, to make a call, initiated by a modem, routed to a control center, for connection to the World Wide Web. X transmits the requested information over its satellite capacity leased from S to C's personal computer. X charges its customers a flat monthly fee. Assume neither X nor S derive international communications income within the meaning of § 1.863–9(d)(3)(ii).

(ii) *Analysis.* In this case, X performs a service, and X's activity in space is not simply facilitation within the meaning of paragraph (d)(2)(ii)(B) of this section, because X's activity is not simply the facilitation of X's own communications and because X's activity is not just part of another service provided by X. Thus, X's activity constitutes space activity in its entirety under paragraph (d)(2)(ii)(A) of this section, and the source of X's income is determined under paragraph (b) of this section. To the extent X derives income from communications activity, within the meaning of § 1.863–9(d), the source of X's income is determined under § 1.863–9(b), as provided in paragraph (b)(6) of this section. S derives communications income within the meaning of § 1.863–9(d), and therefore the source of S's income is determined under § 1.863–9(b), as provided in paragraph (b)(6) of this section.

Example 3. Services as space activity—facilitation of communications. (i) *Facts.* R owns a retail outlet in the United States. R employs S to provide a security system for R's premises. S operates its security system by transmitting images from R's premises to a satellite, and from there to a group of S employees located in Country B, who then monitor the premises by viewing the transmitted images. O provides S with transponder capacity on O's satellite, which S uses to transmit those images.

(ii) *Analysis.* S derives income for providing monitoring services. Because, in this case, S uses O's satellite transponder to transmit images to facilitate S's own communications in space as part of its provision of a security service, S's activity in space is limited to facilitating communications as described in paragraph (d)(2)(ii)(B) of this section. Thus, S is not engaged in a space activity, and none of S's income is space income. Assuming O's provision of capacity is viewed as the provision of a service, O's activity in space is not simply the facilitation of communications as provided in paragraph (d)(2)(ii)(B) of this section, because O is not just facilitating its own communications. Thus, O's activity is characterized as space activity in its entirety under paragraph (d)(2)(ii)(A) of this section (unless O's activity in space qualifies as international communications activity). To the extent O derives income from communications activity, within the meaning of § 1.863–9(d), the source of O's income is determined under § 1863–9(b), as provided in paragraph (b)(6) of this section. On these facts, R does not derive any income from space activity.

Example 4. Space activity. (i) *Facts.* L, a U.S. company, offers programming and also certain services to customers located both in the United States and in foreign countries. Assume L's provision of programming and services in this case was viewed as the provision of a service, with no part of that service occurring in space. L uses satellite capacity acquired from S to deliver the service directly to customers' television sets, so that the delivery of the service occurs in space. Assume the delivery in this case is not considered de minimis. L also acquires programming from H, and L pays H a royalty for use of copyrighted material in the United States and in foreign countries. Customer, C, pays L for delivery of the service to C's residence in the United States. Assume S's provision of capacity in this case was viewed as the provision of a service, and also that S does not derive international communications income within the meaning of § 1.863–9(d)(3)(ii).

(ii) *Analysis.* On these facts, S's activity in space is not just the facilitation of its own communications within the meaning of paragraph (d)(2)(ii)(B) of this section, because S is facilitating the communications of others. To the extent S derives income from a space activity that is also a communications activity under § 1.863–9(d), the source of S's income is determined under § 1.863–9(b), as provided in paragraph (b)(6) of this section. On these facts, L is treated as providing a service and is paid to deliver that service to its customers, and each transaction, i.e., the provision of the service and the delivery of the service, constitutes a separate transaction. L's income derived from provision of the service is not income derived from space activity. L's income derived from delivery of the service is space activity. L's delivery of the service is not just the facilitation of L's own communications within the meaning of paragraph (d)(2)(ii)(B) of this section, because it is not just a part of the provision of a service, but instead the entire service. Since L derives communications income within the meaning of § 1.863–9(d), the source of L's income is determined under § 1.863–9(b), as provided in paragraph (b)(6) of this section. If on other facts, L provides a service and delivers that service, and L treats the provision of the service and the delivery of the service as one separate transaction, then L performs services in space under paragraph (d)(2)(ii)(A) of this section, because the delivery of the service occurs in space. However, L's activity in space would be limited to facilitating its own communications within the meaning of paragraph (d)(2)(ii)(B) of this section, because it is part of another service that would not otherwise be a space activity. As a result, L's provision of the service would not be a space activity under paragraph (d)(2)(ii)(A) of this section.

Example 5. Space activity—treatment of land activity. (i) *Facts.* S, a U.S. person, offers remote imaging products and services to its customers. In year 1, S uses its satellite's remote sensors to gather data on certain geographical terrain. In year 3, C, a construction development company, contracts with S to obtain a satellite image of an area for site development work. S pulls data from its archives and transfers to C the images gathered in year 1, in a transaction that is characterized as a sale of the data. Title to the data passes to C in the United States. Before transferring the images to C, S uses computer software to enhance the images so that the images can be used.

(ii) *Analysis.* The collection of data and creation of images in space is characterized as the creation of property in space. S's income is derived from production of property in part in space, and is, therefore, derived in part from space activity. The source of S's income from production and sale of property is, therefore, determined under paragraph (b)(4) of this section. Since production activity occurs both in space and on land, the source of S's production income is determined under paragraphs (b)(4)(ii)(A) and (C) of this section. The source of S's

income attributable to sales activity is determined under paragraph (b)(4)(ii)(A) of this section and § 1.863–3(c)(2) as U.S. source income.

Example 6. Use of intangible property in space. (i) *Facts.* X acquires a license to use a particular satellite slot or orbit, which X sublicenses to C. C pays X a royalty.

(ii) *Analysis.* Since the royalty is paid for the right to use intangible property in space, the source of X's royalty is determined under paragraph (b) of this section.

Example 7. Performance of services.

(i) *Facts.* E, a U.S. company, operates satellites with sensing equipment that can determine how much heat and light particular plants emit and reflect. Based on the data, E will provide F, a U.S. farmer, a report analyzing the data, which F will use in growing crops. E analyzes the data from U.S. offices.

(ii) *Analysis.* Assume E's combined activities are characterized as the performance of services. Because part of the service is performed in space, all income E derives from the transaction will be treated as derived from space activity under paragraph (d)(2)(ii)(A) of this section. The source of such income will be determined under paragraph (b)(5) of this section. If, however, E can allocate gross income, to the satisfaction of the Commissioner, as prescribed in paragraph (b)(5) of this section, then the source of gross income attributable to services performed outside space may be determined as provided in paragraph (b)(5) of this section.

Example 8. Separate transactions.

(i) *Facts.* The same facts as *Example 7,* except that E provides the raw data to F in a transaction characterized as a sale of a copyrighted article, and in addition also provides an analysis in the form of a report to F, a U.S. farmer who uses the information in growing crops. The price F pays E for the raw data is separately stated.

(ii) *Analysis.* To the extent the provision of raw data and the analysis of the data are each treated as separate transactions, the source of income from the production and sale of data is determined under paragraph (b)(4) of this section. The provision of services would be analyzed in the same manner as in *Example 7.*

Example 9. Sale of property under international water.

(i) *Facts.* T owns transatlantic cable lying under the ocean, which it purchased. T sells the cable to B.

(ii) *Analysis.* Because the property is sold under international water as provided in paragraph (d)(2)(iii) of this section, the transaction is ocean activity under paragraph (d)(1)(ii) of this section, and the source of income is determined under paragraph (b)(4)(i) of this section, by reference to paragraph (b)(1), (2), or (3) of this section.

Example 10. Sales of property in space.

(i) *Facts.* S manufactures a satellite in the United States and sells it to a U.S. customer, with the rights, title, and interest passing to the customer when the satellite is located in space.

(ii) *Analysis.* The source of income derived from the sale of the satellite in space is determined under paragraph (b)(4) of this section, with the source of income attributable to production activity determined under paragraphs (b)(4)(ii)(A) and (B) of this section, and the source of income attributable to sales activity determined under paragraphs (b)(4)(ii)(A) and (b)(4)(i) of this section, by reference to paragraph (b)(1), (2), or (3) of this section.

Example 11. Sale of property located in space.

(i) *Facts.* S has a right to operate from a particular position in space. S sells the right to operate from that satellite slot or orbit to P.

(ii) *Analysis.* Because the sale takes place in space, as provided in paragraph (d)(2)(iii) of this section, gain on the sale of the satellite slot or orbit is income derived from space activity under paragraph (d)(1)(i) of this section, and income from the sale is sourced under paragraph (b)(4)(i) of this section, by reference to paragraph (b)(1), (2), or (3) of this section.

Example 12. Source of income of a foreign person.

(1) *Facts.* FP, a foreign company, not a controlled foreign corporation within the meaning of section 957, derives income from the operation of satellites. FP operates a ground station in the United States and in foreign country, FC.

(ii) *Analysis.* In this case, FP is engaged in a U.S. trade or business of operating the ground station. Thus, under paragraph (b)(3) of this section, all FP's income derived from space activity is presumed to be U.S. source income. However, if FP can allocate space income to contributions occurring outside the United States, space, and international water, as provided in paragraph (b)(3) of this section, for example, to the ground station located in FC, then such space income so allocated will be from sources outside the United States.

Example 13. Source of income of a foreign person.

(i) *Facts.* FP, a foreign company, not a controlled foreign corporation within the meaning of Section 957, operates remote sensing satellites, collecting data and images in space for its customers. FP uses an independent agent, A, in the United States who provides marketing, order taking, and other customer service functions.

(ii) *Analysis.* In this case, FP is engaged in a U.S. trade or business on the basis of A's activities on its behalf in the United States. Therefore, under paragraph (b)(3) of this section, all of FP's income derived from space activity is presumed to be space income. However, if FP can allocate income to contributions occurring outside the United States, space, and international water, as provided in paragraph (b)(3) of this section, then such income so allocated will be from sources outside the United States.

(g) *Reporting and documentation requirements.* When a taxpayer allocates gross income, to the satisfaction of the Commissioner, under paragraph (b)(3), (b)(4)(ii)(C), or (b)(5) of this section, it does so by making the allocation on a timely filed original return (including extensions). An amended return does not qualify for this purpose, nor shall the provisions of § 301.9100–1 of this chapter and any guidance promulgated thereunder apply. In all cases, a taxpayer must maintain contemporaneous documentation in existence when such return is filed regarding the allocation of gross income and allocation or apportionment of expenses, losses and other deductions, the methodology used, and the circumstances justifying use of that methodology. The taxpayer must produce such documentation within 30 days upon request.

(h) *Effective date.* This section applies to taxable years beginning on or after the date that is 30 days after the date of publication of final regulations in the **Federal Register**.

§ 1.863–9 Source of income derived from communications activity under sections 863(a), (d), and (e).

(a) *In general.* Income of a U.S. or foreign person derived from communications activity is sourced under the rules of this section, notwithstanding any other provision including sections 861, 862, 863, and 865.

(b) *Source of gross income derived from communications activity*—(1) *In general.* The source of gross income derived from each type of communications activity, as defined in paragraph (d)(3) of this section, is determined under this paragraph (b). If a communications activity would qualify as space or ocean activity under section 863(d) and the regulations thereunder, the source of income derived from such communications activity is determined under this section, and not under section 863(d) and the regulations thereunder. See § 1.863–8(b)(6).

(2) *Source of international communications income*—(i) *Income derived by a U.S. person.* Under the 50/50 method of this paragraph (b)(2)(i), income derived by a U.S. person from international communications activity is one-half from sources within the United States and one-half from sources without the United States.

(ii) *Income derived by foreign persons*—(A) *General rule.* Income derived by a person other than a U.S. person from international communications activity is, except as otherwise provided in this paragraph (b), wholly from sources without the United States.

(B) *Income derived by certain foreign corporations.* If a foreign corporation, including a controlled foreign corporation within the meaning of section 957, is 50 percent or more owned by vote or value (directly,

indirectly, or constructively) by U.S. persons, all income derived by that corporation from international communications activity is from sources within the United States.

(C) *Income derived by foreign persons with a U.S. fixed place of business.* If a foreign person (other than a foreign person described in paragraph (b)(2)(ii)(B) of this section) maintains an office or other fixed place of business in the United States, the foreign person's international communications income, as determined to the satisfaction of the Commissioner, attributable to the office or other fixed place of business is from sources within the United States. The principles of section 864(c)(5) apply in determining whether a foreign person has an office or fixed place of business in the United States. See § 1.864–6 and –7. This paragraph does not apply if the foreign person is engaged in a U.S. trade or business.

(D) *Income derived by foreign persons engaged in a U.S. trade or business.* If a foreign person (other than a foreign person described in paragraph (b)(2)(ii)(B) of this section) is engaged in a U.S. trade or business, all of the foreign person's international communications income is presumed to be from sources within the United States. However, if the foreign person can allocate income between sources within the United States, or space, or international water and sources outside the United States and space and international water, to the satisfaction of the Commissioner, based on the facts and circumstances, which may include functions performed, resources employed, risks assumed, or other contributions to value, then the income allocated to sources outside the United States and space and international water shall be treated as from sources without the United States.

(3) *Source of U.S. communications income.* The source of income derived by a U.S. or a foreign person from U.S. communications activity is from sources within the United States.

(4) *Source of foreign communications income.* The source of income derived by a U.S. or a foreign person from foreign communications activity is from sources without the United States.

(5) *Source of space/ocean communications income.* The source of income derived by a U.S. or a foreign person from space/ocean communications activity is determined under section 863(d) and the regulations thereunder, without regard to § 1.863–8(b)(6).

(6) *Source of communications income when taxpayer cannot establish the two points between which the taxpayer is paid to transmit the communication.* The income derived by a U.S. person or foreign person from communications activity, when the taxpayer cannot establish the two points between which the taxpayer is paid to transmit the communication as required in paragraph (d)(3)(i) of this section, is from sources within the United States.

(c) *Taxable income.* When a taxpayer allocates gross income under paragraph (b)(2)(ii)(D) or (d)(1)(ii) of this section, to the satisfaction of the Commissioner, based on all the facts and circumstances, the taxpayer must allocate or apportion expenses, losses, and other deductions as prescribed in §§ 1.861–8 through 1.861–14T to the class of gross income, which must include the total income so allocated in each case. A taxpayer must then apply the rules of §§ 1.861–8 through 1.861–14T to properly allocate or apportion amounts of expenses, losses, and other deductions allocated or apportioned to such gross income between gross income from sources within the United States and without the United States. For amounts of expenses, losses, and other deductions allocated or apportioned to gross income derived from international communications activity, when the source of income is determined under the 50/50 method of paragraph (b)(2)(i) of this section, taxpayers must apportion expenses, losses, and other deductions between sources within and sources without pro rata based on the relative amounts of gross income from sources within the United States and without the United States. Research and experimental expenditures qualifying under § 1.861–17 are allocated under that section, and are not allocated and apportioned pro rata under the method of paragraph (b)(2)(i) of this section.

(d) *Communications activity and income derived from communications activity*—(1) *Communications activity*—(i) *General rule.* For purposes of this part, communications activity consists solely of the delivery by transmission of communications or data (communications). Delivery of communications other than by transmission, for example, by delivery of physical packages and letters, is not communications activity within the meaning of this section. Communications activity also includes the provision of capacity to transmit communications. Provision of content or any other additional service provided along with, or in connection with, a non-de minimis communications activity must be treated as a separate non-communications activity unless de minimis.

(ii) *Separate transaction.* To the extent a taxpayer's transaction consists in part of non-de minimis communications activity and in part of non-de minimis non-communications activity, such parts of the transaction must be treated as separate transactions. Gross income must be allocated to each such transaction involving the communications activity and the non-communications activity to the satisfaction of the Commissioner, based on all relevant facts and circumstances, which may include functions performed, resources employed, risks assumed, and any other contributions to the value of the respective transactions. For purposes of determining whether income is derived from communications activity, the Commissioner may treat communications activity and non-communications activity, treated as a single transaction, as separate transactions, or combine separate communications activity and non-communications activity transactions into a single transaction.

(2) *Income derived from communications activity.* Income derived from communications activity (communications income) is income derived from the delivery by transmission of communications, including income derived from the provision of capacity to transmit communications. Income may be considered derived from a communications activity even if the taxpayer itself does not perform the transmission function, but in all cases, the taxpayer derives communications income only if the taxpayer is paid to transmit, and bears the risk of transmitting, the communications.

(3) *Determining the type of communications activity*—(i) *In general.* Whether income is derived from international communications activity, U.S. communications activity, foreign communications activity, or space/ocean communications activity is determined by identifying the two points between which the taxpayer is paid to transmit the communication. The taxpayer must establish to the satisfaction of the Commissioner the two points between which the taxpayer is paid to transmit, and bears the risk of transmitting, the communication. Whether the taxpayer contracts out part or all of the transmission function is not relevant.

(ii) *Income derived from international communications activity.* Income derived by a taxpayer from international communications activity (international communications income) is income derived from communications activity, as defined in paragraph (d)(1) of this

section, when the taxpayer is paid to transmit between a point in the United States and a point in a foreign country (or a possession of the United States).

(iii) *Income derived from U.S. communications activity.* Income derived by a taxpayer from U.S. communications activity (U.S. communications income) is income derived from communications activity, as defined in paragraph (d)(1) of this section, when the taxpayer is paid to transmit—

(A) Between two points in the United States; or

(B) Between the United States and a point in space or in international water.

(iv) *Income derived from foreign communications activity.* Income derived by a taxpayer from foreign communications activity (foreign communications income) is income derived from communications activity, as defined in paragraph (d)(1) of this section, when the taxpayer is paid to transmit—

(A) Between two points in a foreign country or countries (or possession or possessions of the United States); or

(B) Between a foreign country (or a possession of the United States) and a point in space or in international water.

(v) *Income derived from space/ocean communications activity.* Income derived by a taxpayer from space/ocean communications activity (space/ocean communications income) is income derived from a communications activity, as defined in paragraph (d)(1) of this section, when the taxpayer is paid to transmit between a point in space or in international water and another point in space or in international water.

(e) *Treatment of partnerships*—(1) *General.* In the case of a U.S. partnership, this section will be applied at the partnership level. In the case of a foreign partnership, this section will be applied at the partner level.

(2) *Exception.* In the case of a U.S. partnership in which 50 percent or more of the partnership interests are owned by foreign persons, this section will be applied at the partner level.

(f) *Examples.* The following examples illustrate the rules of this section:

Example 1. Income derived from communications activity. (i) *Facts.* D provides its customers in various foreign countries with access to its data base. A customer, C, places a toll call to D's telephone number, and can then access D's data base to obtain certain information, such as C's customers' health care coverage.

(ii) *Analysis.* D is not paid to transmit communications and does not derive income solely from transmission of communications within the meaning of paragraph (d) of this section. D instead derives income from provision of content or provision of services to its customers.

Example 2. Income derived from U.S. communications activity. (i) *Facts.* Local telephone company (TC) receives access fees from an international carrier for picking up calls from a local telephone customer and delivering the call to a U.S. point of presence (POP) of the international carrier. The international carrier picks up the call from its U.S. POP and delivers the call to a foreign country.

(ii) *Analysis.* TC is not paid to carry the transmission between the United States and a foreign country. It is paid to transmit communications between two points in the United States. TC derives income from U.S. communications activity as defined in paragraph (d)(3)(iii) of this section, which is sourced under paragraph (b)(3) of this section as U.S. source income.

Example 3. Income derived from international communications activity. (i) *Facts.* TC, a U.S. company, owns an underwater fiber optic cable. Pursuant to three year contracts, TC makes capacity to transmit communications via the cable available to its customers. Such customers then solicit telephone customers and arrange for transmitting their calls. The cable runs in part through U.S. waters, through international waters, and in part through foreign country waters.

(ii) *Analysis.* TC derives income from communications activity under paragraph (d)(2) of this section. The income is derived from international communications activity as provided in paragraph (d)(3)(ii) of this section, since TC is paid to make available capacity to transmit between the United States and a foreign country, and vice versa. Since TC is a U.S. person, TC's international communications income is sourced under paragraph (b)(2)(i) of this section as one-half from sources within the United States and one-half from sources without the United States.

Example 4. Character of communications activity: the paid-to-do rule. (i) *Facts.* TC is paid to transmit communications from Toronto, Canada, to Paris, France. TC transmits the communication to New York. TC pays another communications company, IC, to transmit the communications from New York to Paris.

(ii) *Analysis.* Under the paid-to-do rule of paragraph (d)(3)(i) of this section, TC derives income from foreign communications activity under paragraph (d)(3)(iv) of this section, since it is paid to transmit communications between two foreign points, Toronto and Paris. Under paragraph (d)(3)(i) of this section, the character of TC's activity is determined without regard to the fact that TC pays IC to transmit the communication for some portion of the delivery path. IC has international communications income under paragraph (d)(3)(ii) of this section, because it is paid to transmit the communication between a point in the United States and a point in a foreign country.

Example 5. Income derived from international communications activity. (i) *Facts.* S, a U.S. satellite operator, owns satellites and the uplink facilities in Country X, a foreign country. B, a resident of Country X, pays S to deliver its programming from Country X to its downlink facility in the United States, owned by C, a customer of B.

(ii) *Analysis.* S derives communications income under paragraph (d) of this section. S's income is characterized as international communications income under paragraph (d)(3)(ii) of this section, because S is paid to transmit the communication between the beginning point in a foreign country to an end point in the United States. The source of S's international communications income is determined under paragraph (b)(2)(i) of this section as one-half from sources within the United States and one-half from sources without the United States.

Example 6. Character of income derived from communications activity: the paid-to-do rule. (i) *Facts.* TC is paid to take a call from North Carolina to Iowa, two points in the United States, but routes the call through Canada.

(ii) *Analysis.* Under paragraph (d)(3)(i) of this section, the character of the income derived from communications activity is determined by the two points between which the taxpayer is paid to transmit, and bears the risk of transmitting, the communications, without regard to the path of the transmission between those two points. Thus, under paragraph (d)(3)(iii) of this section, TC derives income from U.S. communications activity because it is paid to transmit between two U.S. points.

Example 7. Source of income derived from communications activity. (i) *Facts.* A, a U.S. company, is an Internet access provider. A charges C a lump sum, paid monthly, for Internet access. A transmits a call made by C in France to a recipient in England, over the public Internet. A does not maintain records as to the beginning and end points of the transmission.

(ii) *Analysis.* Although A derives income from communications activity as defined in paragraph (d)(1) of this section, the source of income is determined under paragraph (b)(6) of this section as income from sources within the United States, because A cannot establish the two points between which it is paid to transmit the communications.

Example 8. Income derived from communications and non-communications activity. (i) *Facts.* A, a U.S. company, offers customers local and long distance phone service, video, and Internet services. Customers pay one monthly fee, and in addition 10 cents a minute for all long-distance calls, including international calls.

(ii) *Analysis.* To the extent A derives income from communications activity, A must allocate income to its communications activity as provided in paragraph (d)(1)(ii) of this section. To the extent A can establish that it derives international communications income as defined in paragraph (d)(3)(ii) of this section, A would determine the source of such income under paragraph (b)(2)(i) of this section. If A cannot establish the points between which it is paid to transmit communications, as required in paragraph (d)(3)(i) of this section, the source of A's income must be determined under paragraph (b)(6) of this section as from within the United States.

Example 9. Income derived from communications activity. (i) *Facts.* T

purchases capacity from TC to transmit telephone calls. T sells prepaid telephone calling cards, giving customers access to TC's lines, for a certain number of minutes.

(ii) *Analysis.* T derives income from communications activity, under paragraph (d)(2) of this section, because T makes capacity to transmit available to its customers. In this case, T cannot establish the points between which communications are transmitted. Therefore, the source of its income must be determined under paragraph (b)(6) of this section as U.S. source income.

Example 10. Income derived from communications and non-communications activity. (i) *Facts.* B, a U.S. company, transmits television programs using its satellite transponder, from the United States to downlink facilities in foreign country Y, owned by D, a cable system operator in Country Y. D receives the transmission, unscrambles the signals, and distributes the broadcast to customers in Country Y.

(ii) *Analysis.* B derives income both from communications activity as defined under paragraph (d)(1)(i) of this section, and from non-communications activity. Gross income must be allocated to the communications activity as required in paragraph (d)(1)(ii) of this section. Income derived by B for transmission to D is international communications income within paragraph (d)(3)(ii) of this section, because B is paid to transmit communications from the United States to a foreign country.

Example 11. Income derived from communications activity. (i) *Facts.* TC is paid for Internet access. TC replicates frequently requested sites on its servers, solely to speed up response time.

(ii) *Analysis.* On these facts, the replication service would be treated as de minimis under paragraph (d)(1)(i) of this section, so that TC derives income from communications activity. The type and source of TC's communications income depends on demonstrating the points between which TC is paid by its customer to transmit the communications, under paragraph (d)(3)(i) of this section.

Example 12. Income derived from foreign communications activity. (i) *Facts.* S leases capacity to B, a broadcaster located in Australia. B beams programming to the satellite, and S's satellite picks the communications up in space, and beams the programming over Southeast Asia.

(ii) *Analysis.* S derives income from communications activity under paragraph (d)(2) of this section. S's income is characterized as income derived from foreign communications activity under paragraph (d)(3)(iv) of this section, because S picks up the communication in space, and beams it to a footprint entirely covering a foreign area. The source of S's income is determined under paragraph (b)(4) of this section as from sources without the United States. If S were beaming the programming over a satellite footprint that covered area both in the United States and outside the United States, S would be required to allocate the income derived from the different types of communications activity.

(g) *Reporting rules and disclosure on tax return.* When a taxpayer allocates gross income to the satisfaction of the Commissioner under paragraph (b)(2)(ii)(D) or (d)(1)(ii) of this section, it does so by making the allocation on a timely filed original return (including extensions). An amended return does not qualify for this purpose, nor shall the provisions of § 301.9100–1 of this chapter and any guidance promulgated thereunder apply. In all cases, a taxpayer must maintain contemporaneous documentation in existence when such return is filed regarding the allocation of gross income, and allocation and apportionment of expenses, losses, and other deductions, the methodology used, and the circumstances justifying use of that methodology. The taxpayer must produce such documentation within 30 days of a request.

(h) *Effective date.* This section applies to taxable years beginning on or after the date that is 30 days after the date of publication of final regulations in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 01–7 Filed 1–16–01; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–109481–99]

RIN 1545–AX34

Special Rules Under Section 417(a)(7) for Written Explanations Provided by Qualified Retirement Plans After Annuity Starting Dates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the special rule added by the Small Business Job Protection Act of 1996 which permits the required written explanations of certain annuity benefits to be provided by qualified retirement plans to plan participants after the annuity starting date. These regulations affect administrators of, participants in, and beneficiaries of qualified retirement plans.

DATES: Written and electronic comments and requests for a public hearing must be received by April 17, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–109481–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–109481–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax__regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Robert M. Walsh, (202) 622–6090; concerning submissions and delivery of comments, Sonya Cruse (202) 622–7180 (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, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by March 19, 2001. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 services to provide information.

The collection of information in this proposed regulation is in § 1.417(e)–1(b)(3)(iv)(B) and § 1.417(e)–