

business in the United States the gross income shall include only (1) the gross income from sources within the United States which is described in section 881(a) and paragraphs (b) and (c) of § 1.881-2, and (2) the gross income from sources within the United States which, by reason of section 882 (d) or (e) and § 1.882-2, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation.

(c) *Foreign corporations engaged in U.S. business.* In the case of a foreign corporation which is engaged in trade or business in the United States at any time during the taxable year, the gross income shall include (1) the gross income from sources within and without the United States which is effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation, (2) the gross income from sources within the United States which, by reason of section 882 (d) or (e) and § 1.882-2, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation, and (3) the gross income from sources within the United States which is described in section 881(a) and paragraphs (b) and (c) of § 1.881-2 and is not effectively connected for the taxable year with the conduct of a trade or business in the United States by that corporation.

(d) *Effective date.* This section applies for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.882-2 (Revised as of January 1, 1971).

[T.D. 7293, 38 FR 32799, Nov. 28, 1973]

§ 1.882-4 Allowance of deductions and credits to foreign corporations.

(a) *Foreign corporations—(1) In general.* A foreign corporation that is engaged in, or receives income treated as effectively connected with, a trade or business within the United States is allowed the deductions which are properly allocated and apportioned to the foreign corporation's gross income which is effectively connected, or treated as effectively connected, with its conduct of a trade or business within the United States. The foreign cor-

poration is entitled to credits which are attributable to that effectively connected income. No provision of this section (other than paragraph (b)(2)) shall be construed to deny the credits provided by sections 33, 34 and 852(b)(3)(D)(ii) or the deduction allowed by section 170.

(2) *Return necessary.* A foreign corporation shall receive the benefit of the deductions and credits otherwise allowed to it with respect to the income tax, only if it timely files or causes to be filed with the Philadelphia Service Center, in the manner prescribed in subtitle F, a true and accurate return of its taxable income which is effectively connected, or treated as effectively connected, for the taxable year with the conduct of a trade or business in the United States by that corporation. The deductions and credits allowed such a corporation electing under a tax convention to be subject to tax on a net basis may be obtained by filing a return of income in the manner prescribed in the regulations (if any) under the tax convention or under any other guidance issued by the Commissioner.

(3) *Filing deadline for return.* (i) As provided in paragraph (a)(2) of this section, for purposes of computing the foreign corporation's taxable income for any taxable year, otherwise allowable deductions (other than that allowed by section 170) and credits (other than those allowed by sections 33, 34 and 852(b)(3)(D)(ii)) will be allowed only if a return for that taxable year is filed by the foreign corporation on a timely basis. For taxable years of a foreign corporation ending after July 31, 1990, whether a return for the current taxable year has been filed on a timely basis is dependent upon whether the foreign corporation filed a return for the taxable year immediately preceding the current taxable year. If a return was filed for that immediately preceding taxable year, or if the current taxable year is the first taxable year of the foreign corporation for which a return is required to be filed, the required return for the current taxable year must be filed within 18 months of the due date as set forth in section 6072 and the regulations under that section, for filing the return for

the current taxable year. If no return for the taxable year immediately preceding the current taxable year has been filed, the required return for the current taxable year (other than the first taxable year of the foreign corporation for which a return is required to be filed) must have been filed no later than the earlier of the date which is 18 months after the due date, as set forth in section 6072, for filing the return for the current taxable year or the date the Internal Revenue Service mails a notice to the foreign corporation advising the corporation that the current year tax return has not been filed and that no deductions (other than that allowed under section 170) or credits (other than those allowed under sections 33, 34 and 852(b)(3)(D)(ii)) may be claimed by the taxpayer.

(ii) The filing deadlines set forth in paragraph (a)(3)(i) of this section may be waived by the District Director or Assistant Commissioner (International), in rare and unusual circumstances if good cause for such waiver, based on the facts and circumstances, is established by the foreign corporation.

(iii) A foreign corporation which has a permanent establishment, as defined in an income tax treaty between the United States and the foreign corporation's country of residence, in the United States is subject to the filing deadlines set forth in paragraph (a)(3)(i) of this section.

(iv) If a foreign corporation conducts limited activities in the United States in a taxable year which the foreign corporation determines does not give rise to gross income which is effectively connected with the conduct of a trade or business within the United States as defined in sections 882(b) and 864 (b) and (c) and the regulations under those sections, the foreign corporation may nonetheless file a return for that taxable year on a timely basis under paragraph (a)(3)(i) of this section and thereby protect the right to receive the benefit of the deductions and credits attributable to that gross income if it is later determined, after the return was filed, that the original determination was incorrect. On that timely filed return, the foreign corporation is not required to report any gross income as

effectively connected with a United States trade or business or any deductions or credits but should attach a statement indicating that the return is being filed for the reason set forth in this paragraph (a)(3). If the foreign corporation determines that part of the activities which it conducts in the United States in a taxable year gives rise to gross income which is effectively connected with the conduct of a trade or business and part does not, the foreign corporation must timely file a return for that taxable year to report the gross income determined to be effectively connected, or treated as effectively connected, with the conduct of the trade or business within the United States and the deductions and credits attributable to the gross income. In addition, the foreign corporation should attach to that return the statement described in this paragraph (b)(3) with regard to the other activities. The foreign corporation may follow the same procedure if it determines initially that it has no United States tax liability under the provisions of an applicable income tax treaty. In the event the foreign corporation relies on the provisions of an income tax treaty to reduce or eliminate the income subject to taxation, or to reduce the rate of tax, disclosure may be required pursuant to section 6114.

(v) In order to be eligible for any deductions and credits for purposes of computing the accumulated earnings tax of section 531, a foreign corporation must file a true and accurate return; on a timely basis, in the manner as set forth in paragraph (a) (2) and (3) of this section.

(4) *Return by Internal Revenue Service.* If a foreign corporation has various sources of income within the United States and a return of income has not been filed, in the manner prescribed by subtitle F, including the filing deadlines set forth in paragraph (a)(3) of this section, the Internal Revenue Service shall:

(i) Cause a return of income to be made,

(ii) Include on the return the income described in §1.882-1 of that corporation from all sources concerning which it has information, and

(iii) Assess the tax and collect it from one or more of those sources of income within the United States, without allowance for any deductions (other than that allowed by section 170) or credits (other than those allowed by sections 33, 34 and 852(b)(3)(D)(ii)).

If the income of the corporation is not effectively connected with, or if the corporation did not receive income that is treated as being effectively connected with, the conduct of a United States trade or business, the tax will be assessed under § 1.882-1(b)(1) on a gross basis, without allowance for any deduction (other than that allowed by section 170) or credit (other than the credits allowed by sections 33, 34 and 852(b)(3)(D)(ii)). If the income is effectively connected, or treated as effectively connected, with the conduct of a United States trade or business, tax will be assessed in accordance with either section 11, 55 or 1201(a) without allowance for any deduction (other than that allowed by section 170) or credit (other than the credits allowed by sections 33, 34 and 852(b)(3)(D)(ii)).

(b) *Allowed deductions and credits*—(1) *In general.* Except for the deduction allowed under section 170 for charitable contributions and gifts (see section 882(c)(1)(B)), deductions are allowed to a foreign corporation only to the extent they are connected with gross income which is effectively connected, or treated as effectively connected, with the conduct of a trade or business in the United States. Deductible expenses (other than interest expense) are properly allocated and apportioned to effectively connected gross income in accordance with the rules of § 1.861-8. For the method of determining the interest deduction allowed to a foreign corporation, see § 1.882-5. Other than the credits allowed by sections 33, 34 and 852(b)(3)(D)(ii), the foreign corporation is entitled to credits only if they are attributable to effectively connected income. See paragraph (a)(2) of this section for the requirement that a return be filed. Except as provided by section 906, a foreign corporation shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(2) *Verification.* At the request of the Internal Revenue Service, a foreign corporation claiming deductions from gross income which is effectively connected, or treated as effectively connected, with the conduct of a trade or business in the United States or credits which are attributable to that income must furnish at the place designated pursuant to § 301.7605-1(a) information sufficient to establish that the corporation is entitled to the deductions and credits in the amounts claimed. All information must be furnished in a form suitable to permit verification of claimed deductions and credits. The Internal Revenue Service may require, as appropriate, that an English translation be provided with any information in a foreign language. If a foreign corporation fails to furnish sufficient information, the Internal Revenue Service may in its discretion disallow any claimed deductions and credits in full or in part. For additional filing requirements and for penalties for failure to provide information, see also section 6038A.

[T.D. 8322, 55 FR 50830, Dec. 11, 1990]

§ 1.882-5 Determination of interest deduction.

(a) *Rules of general application*—(1) *Overview*—(i) *In general.* The amount of interest expense of a foreign corporation that is allocable under section 882(c) to income which is (or is treated as) effectively connected with the conduct of a trade or business within the United States (ECI) is the sum of the interest paid or accrued by the foreign corporation on its liabilities booked in the United States, as adjusted under the three-step process set forth in paragraphs (b), (c), and (d) of this section and the specially allocated interest expense determined under section (a)(1)(ii) of this section. The provisions of this section provide the exclusive rules for allocating interest expense to the ECI of a foreign corporation. Under the three-step process, the total value of the U.S. assets of a foreign corporation is first determined under paragraph (b) of this section (Step 1). Next, the amount of U.S.-connected liabilities is determined under paragraph (c) of this section (Step 2). Finally, the amount of interest paid or accrued on