

Computation of Possessions Corporation Tax Credit Allowed Under Section 936

▶ Attach to your tax return

For calendar year 19 , or other tax year beginning , 19 , and ending , 19 .

Name _____ Employer identification number _____

Part I Gross Income in Applicable Period

Tax year (Use a separate line for each tax year ending with or within your applicable period. Start with the earliest such tax year. See instruction B.)		Name of U.S. possession in which trade or business was actively conducted	Periods in which trade or business was actively conducted in a U.S. possession (Dates are inclusive)	
Beginning (a)	Ending (b)		From— (d)	To— (e)
		(c)		

Gross income during periods shown in columns (d) and (e)

Gross income from the active conduct of a trade or business in a U.S. possession				Gross qualified possession source investment income (i)	All other gross income		
From sources in U.S. possessions (f)	From all other sources outside the U.S. (g)	From sources in the U.S. (h)	From sources in U.S. possessions (j)		From all other sources outside the U.S. (k)	From sources in the U.S. (l)	
Totals							

1 Total gross income in applicable period (add totals of columns (f) through (l))	1	
2 Gross income in applicable period from sources in U.S. possessions (add total of columns (f), (i), and (j))	2	
3 Divide line 2 by line 1 (if less than 80%, do not complete Parts II and III)	3	
4 Gross income from the active conduct of a trade or business in a U.S. possession (total of columns (f), (g), and (h))	4	
5 Divide line 4 by line 1 (if less than 75%, (see General Instruction B for exception), do not complete Parts II and III)	5	

Part II Computing the Possessions Corporation Tax Credit

<p>6 Qualified gross income in current year:</p> <p>a From sources outside the U.S. from the active conduct of a trade or business in a U.S. possession (see instructions)</p> <p>b From sources outside the U.S. from the sale or exchange of substantially all assets used in a possessions trade or business</p> <p>c Gross qualified possession source investment income</p> <p>d Amounts received in the U.S. (see instructions)</p> <p>e Intangible property income subject to section 936(h)(2)</p> <p>f Other intangible property income (see instructions)</p> <p>g Add lines 6a, 6b, and 6c</p> <p>h Add lines 6d, 6e, and 6f</p> <p>i Subtract line 6h from line 6g</p> <p>7 Applicable deductions (attach schedule):</p> <p>a Cost sharing amount (see instructions)</p> <p>b Definitely allocable deductions (see instructions)</p> <p>c Ratable part of deductions not definitely allocable</p> <p>d Total (add lines 7a, 7b, and 7c)</p> <p>8 Qualified taxable income before adjustments (subtract line 7d from line 6i). If there are no adjustments, enter the amount from this line on line 10</p> <p>9 Adjustments (attach schedule):</p> <p>a Current year losses from nonqualified sources</p> <p>b Recapture of prior year overall foreign losses</p> <p>c Income against which foreign tax credit is claimed</p> <p>d Total (add lines 9a, 9b, and 9c)</p> <p>10 Qualified taxable income (subtract line 9d from line 8)</p> <p>11 Total taxable income from all sources (enter taxable income from your tax return)</p> <p>12 Divide line 10 by line 11</p> <p>13 Total U.S. income tax against which section 936 credit is allowed (see General Instruction C)</p> <p>14 Section 936 credit (multiply line 12 by line 13). Enter here and on your tax return</p>	<p>6a</p> <p>6b</p> <p>6c</p> <p>6d</p> <p>6e</p> <p>6f</p> <p>6g</p> <p>6h</p> <p>7a</p> <p>7b</p> <p>7c</p> <p>9a</p> <p>9b</p> <p>9c</p>	<p>6i</p> <p>7d</p> <p>8</p> <p>9d</p> <p>10</p> <p>11</p> <p>12</p> <p>13</p> <p>14</p>
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Part III Summary From Schedule P (Form 5735) (see instructions)

15 Enter the total sales of possession products to which each income method applies:	
a Cost sharing method	15a
b Profit split method	15b
16 Enter the total sales of possession products which qualify under each business presence test:	
a Direct labor test	16a
b Value-added test	16b
c Alternative test	16c
d Start-up test	16d
e None of the above	16e

Instructions

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping** 11 hrs., 43 min.
- Learning about the law or the form** 2 hrs., 11 min.
- Preparing and sending the form to IRS** 2 hrs., 14 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making the form more simple, we would be happy to hear from you. You can write to either IRS or the Office of Management and Budget at the addresses listed in the instructions for the tax return with which this form is filed.

Other Forms That May Be Required.—Use **Form 5712-A**, Election and Verification of the Cost Sharing or Profit Split Method Under Section 936(h)(5), to elect the cost sharing or profit split method of computing taxable income for these types of income. Form 5712-A is also used to show how possessions corporations satisfied the "significant business presence test." This test must be met before the possessions corporation can use either the cost sharing or profit split method. See section 936(h)(5) and the related regulations for rules concerning the treatment of intangible and other income.

General Instructions

A. Purpose of Form.—A domestic corporation that has elected to be treated as a possessions corporation must attach Form 5735 to its income tax return for each year that the election is in effect. Complete Form 5735 to figure the possessions corporation tax credit under section 936. The credit is allowed against income tax imposed by Chapter 1. Puerto Rico and the Virgin Islands are U.S. possessions for purposes of this credit.

B. Qualifying for the Credit.—To qualify for the possessions tax credit, a corporation must:

- (1) have filed a valid **Form 5712**, Election To Be Treated as a Possessions Corporation Under Section 936;
- (2) have derived 80% or more of its gross income from sources in a U.S. possession during the applicable period immediately before the tax year ended; and
- (3) have derived 75% or more of its gross income from the active conduct of a trade or business in a U.S. possession during the applicable period immediately before the tax year ended. **Exception.** For tax years that begin before 1987, there is an exception to the rule that 75% of gross income be derived from the active conduct of a trade or business in a U.S.

possession. See section 1012(n)(3) of the Technical and Miscellaneous Revenue Act of 1988 for more information.

The "applicable period" is generally the shorter of 36 months or the period when the corporation actively conducted a trade or business in a U.S. possession.

C. Restrictions.—A corporation is ineligible to take the possessions tax credit for any tax year it is a DISC or former DISC, or for any tax year in which it owns stock in a DISC or FSC, or former DISC or former FSC (section 936(f)).

The credit is not allowed against the following taxes:

- environmental tax (section 59A)
- tax on accumulated earnings (section 531)
- personal holding company tax (section 541)
- additional tax for recovery of foreign expropriation losses (section 1351)
- tax increase on the early disposition of investment credit property (section 47)
- tax on certain capital gains of S corporations (section 1374)
- recapture of low-income housing credit (section 42(j)(4)(D))

D. Where To File.—Attach Form 5735 to your income tax return and file your return with the Internal Revenue Service Center, Philadelphia, PA 19255.

E. Alternative Minimum Tax.—Income eligible for the possessions corporation tax credit is not taxed under the alternative minimum tax rules. See Form 4626.

Specific Instructions

Follow sections 638, 861-864, and 936 to determine if the source of gross income, deductions, and taxable income is in or outside the U.S. or in a U.S. possession. Amounts received in the U.S. may be considered sourced outside the U.S. if the amounts are from sources outside the U.S. and received from an unrelated person in the active conduct of a trade or business (section 936(b)).

You cannot take a deduction or foreign tax credit for taxes you paid or accrued to a foreign country or U.S. possession if any of the income on which those taxes were paid or accrued is used in computing the possessions corporation tax credit.

Part I

Column (f).—Enter the gross income from the active conduct of a trade or business in a U.S. possession which is from sources in U.S. possessions. Include amount(s) reported on line 6 of Part II of Schedule(s) P.

Column (i).—Enter gross qualified possession source investment income in column (i). Subject to conditions set forth in regulations, certain investments in a financial institution shall be considered investments for use in Puerto Rico. These investments must be made in financial institutions for investments consistent with the goals of the Caribbean Basin Economic Recovery Act, and must either be invested in active business assets in a qualified Caribbean Basin country or invested in development projects in a qualified Caribbean Basin country, and the investment

must be specifically authorized by the Commissioner of Financial Institutions of Puerto Rico.

Part II

Line 6a.—Include amount(s) reported on line 6 of Part II of Schedule(s) P.

Line 6b.—Include gross income that came from sources outside the U.S. from selling or exchanging substantially all the assets the possessions corporation used in the active conduct of its trade or business.

Line 6d.—Do not include any amount on line 6d that is from sources outside the U.S. and is received from a person who is not a related person in the active conduct of a trade or business in a U.S. possession. Instead, include these amounts on line 6a, 6b, or 6c, whichever is applicable.

Line 6f.—Enter the amount of marketing intangible property income which is associated with any product(s) subject to the cost sharing method and which is not included in the gross income of a shareholder because such a shareholder is a foreign person or a tax-exempt U.S. person. See Regulations section 1.936-6(a)(5).

Line 7a.—Include the sum of all cost sharing amounts entered on line 7 of Part I of Schedule(s) P if the cost sharing method applies.

Line 7b.—Include all amounts entered on line 7 of Part II of Schedule(s) P. Also include the corporation's other definitely allocable deductions.

Line 7c.—Enter on line 7c the ratable part of deductions that cannot be definitely allocated to qualified income. To obtain this figure, reduce the deductions by the amount entered on line 7b. Multiply this result by the amount obtained when you divide the amount entered on line 6i by the gross income on your income tax return.

Line 9a.—If you sustain a loss for the current year on any type of income for which a separate foreign tax credit limit applies, allocate the loss to the possessions income that qualifies for the credit in proportion to the ratio of that income to total taxable income, excluding the loss.

Line 9b.—If you sustain an overall foreign loss in any year, the loss is recaptured in later tax years by treating part of your taxable income from sources outside the U.S. as income from sources in the U.S. (section 904(f)).

Part III

You are not required to complete Part III if you have attached fewer than 10 Schedules P. Part III information will not affect your tax liability. Failure to complete this part, if required, will delay the processing of your Form 5735.

Line 15.—Enter on line 15a the sum of sales of possession products (as reported on line 2 of Part I of Schedule(s) P) subject to the cost sharing method. Enter on line 15b the sum of sales of possession products (as reported on line 2 of Part I of Schedule(s) P) subject to the profit split method.

Line 16.—Enter on lines 16a through 16e the sum of sales of possession products (as reported on line 2 of Part I of Schedule(s) P) which have met the listed business presence test. Total sales included on lines 16a through 16e should equal the total of lines 15a and 15b.