Form **5735** (Rev. January 1982) Department of the Treasury Internal Revenue Service

Computation of Possessions Corporation Tax Credit Allowed Under Section 936

▶ Attach to your tax return

OMB No. 1545-0217 Expires 5-31-84

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.) Beginning (a)	Ending (b)	Name of U.S. possession in which trade or business was actively conducted (c)	Periods in which trade or business was actively conducted in a U.S. possession (Dates are inclusive) From— (d)	To— (e)

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	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)	(i)	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 Part II)	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 50%, do not complete Part II)	5	

Part II Computing the Possessions Corporation Tax Credit

6 Qualified gross income in current year:				
(a) From sources outside the U.S. from the active conduct of a trade or business in a U.S. possession	6(a)			
(b) From sources outside the U.S. from sale or exchange of substantially all of assets used in a possessions trade or business	6(b)			
(c) Gross qualified possession source investment income	6(c)			
(d) Amounts received in the U.S.	6(d)			
(e) Total (add lines 6(a), 6(b), and 6(c) and subtract line 6(d))			6(e)	
7 Applicable deductions (attach schedule):				
(a) Definitely allocable deductions (see instructions)	7(a)			
(b) Ratable part of deductions not definitely allocable	7(b)			
(c) Total (add lines 7(a) and 7(b))			7(c)	
8 Qualified taxable income before loss adjustments (line 6(e) less line 7(c)). If loss, do not complete below			8	
9 Loss adjustments (attach schedule):				
(a) Current year losses from non-qualified sources (see instructions)	9(a)			
(b) Recapture of prior year overall foreign losses (see instructions)	9(b)			
(c) Net capital loss or short-term capital loss adjustment (see instructions)	9(c)			
(d) Total (add lines 9(a), 9(b), and 9(c))			9(d)	
10 Qualified taxable income (subtract line 9(d) from line 8)			10	
11 Total taxable income from all sources (enter taxable income from your tax return)			11	
12 Adjustments to taxable income from all sources (see instructions)			12	
13 Subtract line 12 from line 11			13	
14 Divide line 10 by line 13			14	
15 Total U.S. income tax against which section 936 credit is allowed (see instruction C)			15	
16 Section 936 credit (multiply line 14 by line 15). Enter here and on your tax return ▶			16	

For Paperwork Reduction Act Notice, see instructions on back.

Instructions

(References are to the Internal Revenue Code)

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that you 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.

GENERAL INSTRUCTIONS

A. Purpose.—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 is a U.S. possession for this credit, but the Virgin Islands are not.

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 50% 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.

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 former DISC. (Section 936(f).)

The credit is not allowed against the following taxes:

- minimum tax on tax preference items (section 56).
- 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 electing small business corporations (section 1378).

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.

SPECIFIC INSTRUCTIONS

Follow sections 638 and 861–864 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. If you received any income in the U.S., regardless of its source, do not include it as income from sources outside the U.S. (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 (i).—Enter gross qualified possession source investment income in column (i). You must establish to the satisfaction of the Secretary that this income is from either the investment in a U.S. possession of funds derived in the active conduct of a trade or business in that possession, or from the investment itself. Temporary Regulation 7.936–1 gives information about certain deposits in Puerto Rican banks and other financial institutions that may earn qualified income.

In Part II subtract applicable deductions from this income to figure how much investment income qualifies for the credit.

Part II.—

Line 6(b).—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 7(a).—On line 7(a) include the reduction for the "rate differential portion" (as defined in section 904(b)(3)(F)) of any net capital gain that comes from a foreign source and is included on line 6(e). Also, include the corporation's other definitely allocable deductions.

Line 7(b).—Enter on line 7(b) 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 7(a). Multiply this result by the amount obtained when you divide the amount entered on line 6(e) by the gross income on your income tax return.

Line 8.—Do not include income from selling or exchanging any asset whose basis is determined by reference to its basis in another person's hands. If, however, the asset's basis is determined by reference to its basis in the hands of another person to whom section 931, 936, or 957(c) applied during the whole period the asset was held, the income may qualify (see section 936(d)(3)).

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

Line 9(b).—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)).

Line 9(c).—To the extent any net capital loss or short-term capital loss from sources outside the U.S. is used to determine capital gain net income, it is also used to reduce income against which the credit is allowed. First, however, decrease the loss by the "rate differential portion" of the excess of net capital gain from non-qualified sources over net capital gain. Enter on line 9(c) the amount by which the loss reduces the corporation's income that qualifies for the credit. Attach your computation.

Line 12.—If line 11 includes income from selling or exchanging capital assets, enter the reduction for the "rate differential portion" of net capital gain.