Form **5735** (Rev. October 1986)

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 9-30-89

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)	(c)	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 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 65% (75% for tax years beginning after 1986), do not complete Parts II and III)	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 (see instructions)			6(a)	
(b) From sources outside the U.S. from the sale or exchange of substantially all 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) Intangible property income subject to section 936(h)(2)			6(e)	
(f) Other intangible property income (see instructions)			6(f)	
(g) Add lines 6(a), 6(b), and 6(c)	6(g)			
(h) Add lines 6(d), 6(e), and 6(f)	6(h)			
(i) Subtract line 6(h) from 6(g)			6(i)	
7 Applicable deductions (attach schedule):				
(a) Cost sharing amount (see instructions)			7(a)	
(b) Definitely allocable deductions (see instructions)			7(b)	
(c) Ratable part of deductions not definitely allocable			7(c)	
(d) Total (add lines 7(a), 7(b), and 7(c))			7(d)	
8 Qualified taxable income before loss adjustments (line 6(i) less line 7(d)). If loss, do not complete below			8	
9 Loss adjustments (attach schedule):				
(a) Current year losses from nonqualified 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	

Part III Summary From Schedule P (see instructions)

17 Enter the total sales of possession products to which each income method applies:		
(a) Cost sharing method	17(a)	
(b) Profit split method	17(b)	
18 Enter the total sales of possession products which qualify under each business presence test:		
(a) Direct labor test	18(a)	
(b) Value-added test	18(b)	
(c) Alternative test	18(c)	
(d) Start-up test	18(d)	
(e) None of the above	18(e)	

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.

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 is a U.S. possession for purposes of this credit, and for tax years beginning after1986, the Virgin Islands are also considered a possession.

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 65% (75% for tax years beginning after 1986) 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 FSC or former DISC or former FSC (section 936(f)).

The credit is not allowed against the following taxes:

- minimum tax on tax preference items (section 56) for tax years beginning before 1987
- 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)

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, 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. If you receive any income in the U.S., regardless of its source, do not include it as income from sources outside the U.S. For tax years beginning after 1986, 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 for tax years beginning after 1986 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 authorized by the Government Development Bank of Puerto Rico. See section 936(d)(4).

Part II

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

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

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

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 nonqualified 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, include the reduction for the "rate differential portion" of net capital gain.

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, but failure to complete this part, if you are required to do so, will delay the processing of your Form 5735.

Line 17.—Enter on line 17(a) 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 17(b) the sum of sales of possession products (as reported on line 2 of Part 1 of Schedule(s) P) subject to the profit split method.

Line 18.—Enter on lines 18(a) through 18(e) 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 18(a) through 18(e) should equal the total of lines 17(a) and 17(b).

Minimum Tax.—For tax years beginning after 1986, the minimum tax applies only to income not qualified for the possessions corporation tax credit, therefore, the credit may not be used against the minimum tax.