

$$\text{Interest expense} \times \frac{\text{General limitation assets that are not tax exempt}}{\text{Worldwide assets that are not tax exempt}}$$

$$\$60,000 \times \frac{\$2,000,000}{(\$100,000 + \$900,000 + \$2,000,000)} = \$40,000$$

Nonexempt foreign assets

20 percent of Z stock value + Nonexempt domestic assets + Nonexempt foreign assets

To domestic source income:

$$\text{Interest expense} \times \frac{\text{Domestic assets that are not tax exempt}}{\text{Worldwide assets that are not tax exempt}}$$

$$\$60,000 \times \frac{\$100,000 + \$900,000}{(\$100,000 + \$900,000 + \$2,000,000)} = \$20,000$$

20 percent of Z stock value + nonexempt domestic assets

20 percent of Z stock value + Nonexempt domestic assets + Nonexempt foreign assets

(h) *Effective dates.* In general, the rules of this section, as well as the rules of §§ 1.861-9T, 1.861-10T, 1.861-11T, 1.861-12T, and 1.861-14T shall apply for taxable years beginning after December 31, 1986. However, see §§ 1.861-8(e)(12)(iv) and 1.861-14(e)(6) for rules concerning the allocation and apportionment of deductions for charitable contributions. In the case of corporate taxpayers, transition rules set forth in § 1.861-13T provide for the gradual phase-in of certain the provisions of this and the foregoing sections. However, the following rules are effective for taxable years commencing after December 31, 1988:

(1) Section 1.861-9T(b)(2) (concerning the treatment of certain foreign currency borrowings),

(2) Section 1.861-9T(d)(2) (concerning the treatment of interest incurred by nonresident aliens),

(3) Section 1.861-10T(b)(3)(ii) (providing an operating costs test for purposes of the nonrecourse indebtedness exception), and

(4) Section 1.861-10T(b)(6) (concerning excess collateralization of nonrecourse borrowings).

In addition, § 1.861-10T(e) (concerning the treatment of related controlled for-

eign corporation indebtedness) is effective for taxable years commencing after December 31, 1987. For rules for taxable years beginning before January 1, 1987, and for later years to the extent permitted by § 1.861-13T, see § 1.861-8 (Revised as of April 1, 1986).

[T.D. 8228, 53 FR 35474, Sept. 14, 1988, as amended by T.D. 8286, 55 FR 3054, Jan. 30, 1990; T.D. 8337, 56 FR 10369, Mar. 12, 1991; T.D. 8597, 60 FR 36679, July 18, 1995; T.D. 8805, 64 FR 1509, Jan. 11, 1999; T.D. 8973, 66 FR 67083, Dec. 28, 2001; T.D. 9143, 69 FR 44932, July 28, 2004; T.D. 9211, 70 FR 40663, July 14, 2005]

**§ 1.861-9 Allocation and apportionment of interest expense.**

(a) through (g)(1)(i) [Reserved]. For further guidance, see § 1.861-9T(a) through (g)(1)(i).

(g)(1)(ii) [Reserved]. For further guidance, see the second sentence in § 1.861-9T(g)(1)(ii).

(g)(1)(iii) through (h)(4) [Reserved]. For further guidance, see § 1.861-9T(g)(1)(iii) through (h)(4).

(h)(5) *Characterizing stock in related persons—(i) General rule.* Stock in a related person held by the taxpayer or by another related person shall be characterized on the basis of the fair market value of the taxpayer's pro rata share

of assets held by the related person attributed to each statutory grouping and the residual grouping under the stock characterization rules of § 1.861-12T(c)(3)(ii), except that the portion of the value of intangible assets of the taxpayer and related persons that is apportioned to the related person under § 1.861-9T(h)(2) shall be characterized on the basis of the net income before interest expense of the related person within each statutory grouping or residual grouping (excluding income that is passive under § 1.904-4(b)).

(ii) *Special rule for section 936 corporations regarding alternative minimum tax.* For purposes of characterizing stock in a related section 936 corporation in determining foreign source alternative minimum taxable income within each separate category and the alternative minimum tax foreign tax credit pursuant to section 59(a), the rules of § 1.861-9T(g)(3) shall apply and § 1.861-9(h)(5)(i) shall not apply. Thus, for taxable years beginning after December 31, 1989, and before January 1, 1994, stock in a related section 936 corporation is characterized for alternative minimum tax purposes as a foreign source passive asset because the stock produces foreign source passive dividend income under sections 861(a)(2)(A), 862(a)(2), and 904(d)(2)(A) and the regulations under those sections. For taxable years beginning after December 31, 1993, stock in a related section 936 corporation would be characterized for alternative minimum tax purposes as an asset subject to the separate limitation for section 936 corporation dividends because the stock produces foreign source dividend income that, for alternative minimum tax purposes, is subject to a separate foreign tax credit limitation under section 56(g)(4)(C)(iii)(IV). However, stock in a section 936 corporation is characterized as a U.S. source asset to the extent required by section 904(g). For the definition of the term *section 936 corporation*, see § 1.861-11(d)(2)(ii).

(iii) *Effective date.* This paragraph (h)(5) applies to taxable years beginning after December 31, 1989.

(6) [Reserved] For further guidance, see § 1.861-9T(h)(6).

(i) *Alternative tax book value method—*  
(1) *Alternative value for certain tangible*

*property.* A taxpayer may elect to determine the tax book value of its tangible property that is depreciated under section 168 (section 168 property) using the rules provided in this paragraph (i)(1) (the alternative tax book value method). The alternative tax book value method applies solely for purposes of apportioning expenses (including the calculation of the alternative minimum tax foreign tax credit pursuant to section 59(a)) under the asset method described in paragraph (g) of this section.

(i) The tax book value of section 168 property placed in service during or after the first taxable year to which the election to use the alternative tax book value method applies shall be determined as though such property were subject to the alternative depreciation system set forth in section 168(g) (or a successor provision) for the entire period that such property has been in service.

(ii) In the case of section 168 property placed in service prior to the first taxable year to which the election to use the alternative tax book value method applies, the tax book value of such property shall be determined under the depreciation method, convention, and recovery period provided for under section 168(g) for the first taxable year to which the election applies.

(iii) If a taxpayer revokes an election to use the alternative tax book value method (the prior election) and later makes another election to use the alternative tax book value method (the subsequent election) that is effective for a taxable year that begins within 3 years of the end of the last taxable year to which the prior election applied, the taxpayer shall determine the tax book value of its section 168 property as though the prior election has remained in effect.

(iv) The tax book value of section 168 property shall be determined without regard to the election to expense certain depreciable assets under section 179.

(v) *Examples.* The provisions of this paragraph (i)(1) are illustrated in the following examples:

*Example 1.* In 2000, a taxpayer purchases and places in service section 168 property used solely in the United States. In 2005, the

taxpayer elects to use the alternative tax book value method, effective for the current taxable year. For purposes of determining the tax book value of its section 168 property, the taxpayer's depreciation deduction is determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) as in effect in 2005 to the taxpayer's original cost basis in such property. In 2006, the taxpayer acquires and places in service in the United States new section 168 property. The tax book value of this section 168 property is determined under the rules of section 168(g)(2) applicable to property placed in service in 2006.

*Example 2.* Assume the same facts as in *Example 1*, except that the taxpayer revokes the alternative tax book value method election effective for taxable year 2010. Additionally, in 2011, the taxpayer acquires new section 168 property and places it in service in the United States. If the taxpayer elects to use the alternative tax book value method effective for taxable year 2012, the taxpayer must determine the tax book value of its section 168 property as though the prior election still applied. Thus, the tax book value of property placed in service prior to 2005 would be determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) applicable to property placed in service in 2005. The tax book value of section 168 property placed in service during any taxable year after 2004 would be determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) applicable to property placed in service in such taxable year.

(2) *Timing and scope of election.* (i) Except as provided in this paragraph (i)(2), a taxpayer may elect to use the alternative tax book value method with respect to any taxable year beginning on or after March 26, 2004. However, pursuant to § 1.861-8T(c)(2), a taxpayer that has elected the fair market value method must obtain the consent of the Commissioner prior to electing the alternative tax book value method. Any election made pursuant to this paragraph (i)(2) shall apply to all members of an affiliated group of corporations as defined in §§ 1.861-11(d) and 1.861-11T(d). Any election made pursuant to this paragraph (i)(2) shall apply to all subsequent taxable years of the taxpayer unless revoked by the taxpayer. Revocation of such an election, other than in conjunction with an election to use the fair market value meth-

od, for a taxable year prior to the sixth taxable year for which the election applies requires the consent of the Commissioner.

(ii) *Example.* The provisions of this paragraph (i)(2) are illustrated in the following example:

*Example.* Corporation X, a calendar year taxpayer, elects on its original, timely filed tax return for the taxable year ending December 31, 2007, to use the alternative tax book value method for its 2007 year. The alternative tax book value method applies to Corporation X's 2007 year and all subsequent taxable years. Corporation X may not, without the consent of the Commissioner, revoke its election and determine tax book value using a method other than the alternative tax book value method with respect to any taxable year beginning before January 1, 2012. However, Corporation X may automatically elect to change from the alternative tax book value method to the fair market value method for any open year.

(3) *Certain other adjustments.* [Reserved]

(4) *Effective date.* This paragraph (i) applies to taxable years beginning on or after March 26, 2004.

(j) [Reserved] For further guidance, see § 1.861-9T(j).

[T.D. 8916, 66 FR 272, Jan. 3, 2001, as amended by T.D. 9120, 69 FR 15675, Mar. 26, 2004; T.D. 9247, 71 FR 4814, Jan. 30, 2006]

**§ 1.861-9T Allocation and apportionment of interest expense (temporary).**

(a) *In general.* Any expense that is deductible under section 163 (including original issue discount) constitutes interest expense for purposes of this section, as well as for purposes of §§ 1.861-10T, 1.861-11T, 1.861-12T, and 1.861-13T. The term interest refers to the gross amount of interest expense incurred by a taxpayer in a given tax year. The method of allocation and apportionment for interest set forth in this section is based on the approach that, in general, money is fungible and that interest expense is attributable to all activities and property regardless of any specific purpose for incurring an obligation on which interest is paid. Exceptions to the fungibility rule are set forth in § 1.861-10T. The fungibility approach recognizes that all activities and property require funds and that