§ 1.863–0 Table of contents.

This section lists captions contained in §§ 1.863–1, 1.863–2, and 1.863–3.

Par. 3. Sections 1.863–1, 1.863–2, and 1.863–3 are revised to read as follows:

§ 1.863–1 Allocation of gross income.

(a) *In general.* Items of gross income other than those specified in section 861(a) and section 862(a) will generally be separately allocated to sources within or without the United States. See § 1.863–2 for alternate methods to determine the income from sources within or without the United States in the case of items specified in § 1.863–2(a). See also sections 865(b) and 865(e)(2).

(b) *Natural resources*—(1) *In general.* Except to the extent provided in paragraph (b)(2) of this section, gross receipts from the sale outside the United States of products derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber within the United States, are allocated between sources within or without the United States based on the fair market value of the product at the export terminal (as defined in paragraph (b)(3)(iii) of this section). Except to the extent provided in paragraph (b)(2) of this section, gross receipts from the sale within the United States of products derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber outside the United States are also allocated between sources within or without the United States based on the fair market value of the product at the export terminal. The source of gross receipts equal to the fair market value of the product at the export terminal will be from sources where the farm, mine, well, deposit, or uncut timber is located. The source of gross receipts from the sale of the product in excess of its fair market value at the export terminal (excess gross receipts) will be determined as follows—

(i) If the taxpayer does not engage in additional production activities (as defined in paragraph (b)(3)(ii) of this section), excess gross receipts will be from sources where the farm, mine, well, deposit, or uncut timber is located;

(ii) If the taxpayer engages in additional production activities subsequent to shipment from the export terminal and outside the country of sale, the source of excess gross receipts must be determined under § 1.863–3. For purposes of applying § 1.863–3, only production assets used in additional production activity subsequent to the export terminal are taken into account; or

(iii) In all other cases, excess gross receipts will be from sources within the country of sale, as described in § 1.861–7(c). This paragraph (b)(1)(iii) applies, for example, to a taxpayer that engages in additional production activities in the country of sale.

(2) *Additional production prior to export terminal.* Notwithstanding any other provision of this section, gross receipts from the sale of products derived by a taxpayer who performs additional production activities as defined in paragraph (b)(3)(ii) of this section before the relevant product is shipped from the export terminal are allocated between sources within and without the United States based on the fair market value of the product immediately prior to the additional production activities. The source of gross receipts equal to the fair market value of the product immediately prior to the additional production activities will be from sources where the farm, mine, well, deposit, or uncut timber is located. The source of gross receipts from the sale of the product in excess of the fair market value immediately prior to the additional production activities must be determined under § 1.863–3. For purposes of applying § 1.863–3, only production assets used in the additional production activities are taken into account.

(3) *Definitions*—(i) *Production activity*. For purposes of this section, *production activity* means an activity that creates, fabricates, manufactures, extracts, processes, cures, or ages inventory. See § 1.864–1.

(ii) *Additional production activities.* For purposes of this section, *additional production activities* are substantial production activities performed by the taxpayer in addition to activities from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber. Whether a taxpayer performs such additional production activities will be determined under the principles of § 1.954–3(a)(4). However, in no case will activities that prepare the natural resource itself for export, including those that are designed to facilitate the transportation of the natural resource to or from the export terminal, be considered additional production activities for purposes of this section.

(iii) *Export terminal.* Where the farm, mine, well, deposit, or uncut timber is located without the United States, the export terminal will be the final point in a foreign country from which goods are shipped from a foreign country to the United States. Where the farm, mine, well, deposit, or uncut timber is located within the United States, the export terminal will be the final point in the United States from which goods are shipped from the United States to a foreign country. The export terminal is determined without regard to any contractual terms agreed to by the taxpayer and without regard to whether there is an actual sale of the products at the export terminal.