

income from widgets sold in foreign countries is \$12. A uses the 50/50 method to divide its gross income between production activity and sales activity.

(i) A determines its production gross income from sources without the United States by multiplying one-half of A's \$12 of gross income from sales of widgets in foreign countries, or \$6, by a fraction, the numerator of which is all relevant foreign production assets, or \$25, and the denominator of which is all relevant production assets, or \$75 (\$25 foreign assets + (\$200 U.S. assets \times \$25 gross receipts from export sales/\$100 gross receipts from all sales)). Therefore, A's gross production income from sources without the United States is \$2 ($\$6 \times (\$25/\$75)$).

Example 2. Location of intangible property. Assume the same facts as *Example 1*, except that A employs a patented process that applies only to the initial production of widgets. In computing the formula used to determine the source of income from production activity, A's patent, if it has an average adjusted basis, would be located in the United States.

(2) *Income attributable to sales activity.* The source of the taxpayer's income that is attributable to sales activity will be determined under the provisions of § 1.861-7(c).

(d) *Determination of source of taxable income.* Once the source of gross income has been determined under paragraph (c) of this section, the taxpayer must properly allocate and apportion separately under §§ 1.861-8 through 1.861-14T the amounts of its expenses, losses, and other deductions to its respective amounts of gross income from Section 863 Sales determined separately under each method described in paragraph (b) of this section. In addition, if the taxpayer deducts expenses for research and development under section 174 that may be attributed to its Section 863 Sales under § 1.861-8(e)(3), the taxpayer must separately allocate or apportion expenses, losses, and other deductions to its respective amounts of gross income from each relevant product category that the taxpayer uses in applying the rules of § 1.861-8(e)(3)(i)(A). In the case of gross income from Section 863 Sales determined under the IFP method or the books and records method, the rules of §§ 1.861-8 through 1.861-14T must apply to properly allocate or apportion amounts of expenses, losses and other deductions allocated and apportioned to such gross income between gross income from sources within and without the United States. In the case of gross income from Section 863 Sales determined under the 50/50 method, the amounts of expenses, losses, and other deductions allocated and apportioned to such gross income must be apportioned between sources within and without the United States

pro rata based on the relative amounts of gross income from sources within and without the United States determined under the 50/50 method.

(e) *Election and reporting rules—(1) Elections under paragraph (b) of this section.* If a taxpayer does not elect a method specified in paragraph (b)(2) or (3) of this section, the taxpayer must apply the method specified in paragraph (b)(1) of this section. The taxpayer may elect to apply the method specified in paragraph (b)(2) of this section by using the method on a timely filed original return (including extensions). A taxpayer may elect to apply the method specified in paragraph (b)(3) of this section by using the method on a timely filed original return (including extensions), but only if the taxpayer has received permission from the District Director to apply that method. Once a method under paragraph (b) of this section has been used, that method must be used in later taxable years unless the Commissioner consents to a change. See e.g., paragraph (b)(2)(ii) *Example 2* of this section. However, if a taxpayer elects to change to or from the method specified in paragraph (b)(3) of this section, the taxpayer must obtain permission from the District Director instead of the Commissioner. Permission to change methods from one year to another year will not be withheld unless the change would result in a substantial distortion of the source of the taxpayer's income.

(2) *Disclosure on tax return.* A taxpayer who uses one of the methods described in paragraph (b) of this section must fully explain the methodology used, the circumstances justifying use of that method, the extent that sales are aggregated, and the amount of income so allocated.

(f) *Income partly from sources within a possession of the United States.* [Reserved]

(g) *Effective dates.* The rules of paragraphs (a) through (e) of this section will apply to taxable years beginning 30 days after publication of final regulations. However, taxpayers may apply these regulations for taxable years beginning after July 11, 1995, and before 30 days after publication of these regulations as final regulations. For years beginning before 30 days after the publication of these regulations as final regulations, see § 1.863-3 (as contained in 26 CFR part 1 revised as of April 1, 1995).

Par. 4. Section 1.863-4 is amended by revising the section heading and paragraph (a) to read as follows:

§ 1.863-4 Certain transportation services.

(a) *General.* A taxpayer carrying on the business of transportation service (other than an activity giving rise to transportation income described in section 863(c) or to income subject to other specific provisions of this title) between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

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§ 1.863-5 [Removed]

Par. 6. Section 1.863-5 is removed.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

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DEPARTMENT OF TRANSPORTATION

Office of the Secretary

33 CFR Part 52

[OST Docket No. OST-95-878; Notice 95-14]

RIN 2105-AC31

Coast Guard Board for Correction of Military Records; Procedural Regulation

AGENCY: Office of the Secretary, DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Department proposes to amend its regulations with respect to reconsideration of final decisions of the Board for Correction of Military Records of the Coast Guard (Board). This action is taken on the Department's initiative in order to streamline processing of these cases and to clarify the circumstances under which final decisions can be reconsidered. The proposed amendment will make it possible for the Board to expedite reconsideration and will increase the resources available to meet the requirement that all cases be decided within 10 months of the receipt of a completed application.

DATES: Comments must be submitted on or before February 9, 1996. Late-filed comments will be considered to the extent practicable.

ADDRESSES: Comments should be mailed, preferably in duplicate, to Docket No. OST-95-878, Documentary Services Division, C-55, PL-401, U.S. Department of Transportation; 400 Seventh Street SW, Washington, D.C. 20590. Comments will be available for review by the public at this address from 9 a.m. through 5 p.m., Monday