

Instructions for Form 5735

(Rev. January 2013)



Department of the Treasury
Internal Revenue Service

American Samoa Economic Development Credit

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Section 330 of the American Taxpayer Relief Act of 2012 has modified and expanded the American Samoa economic development credit for tax years beginning after December 31, 2011. This revision reflects those changes. For information on the credit for tax years beginning before January 1, 2012, see the March 2007 revision of Form 5735 and the separate instructions.

General Instructions

Purpose of Form

Form 5735 is used to figure the American Samoa economic development credit under section 30A. The credit is generally allowed against income tax imposed by Chapter 1 (see *Restrictions* below for exceptions).

Who Must File

A domestic corporation (other than an S corporation) must complete Form 5735 for each year the American Samoa economic development credit election is in effect.

Where To File

Attach Form 5735 to the corporation's income tax return and file the return with the Internal Revenue Service, P.O. Box 409101, Ogden, UT 84409.

Qualifying for the Credit

To qualify for the American Samoa economic development credit, a corporation must meet the qualified production activities income (QPAI) requirement. A corporation meets this requirement if it has qualified production activities income (defined below).



The corporation does not qualify for the American Samoa economic development credit unless it has a positive QPAI.

Restrictions

The credit is not allowed against the following taxes:

1. Tax on accumulated earnings (section 531).
2. Personal holding company tax (section 541).
3. Additional tax for recovery of foreign expropriation losses (section 1351).
4. Recapture of investment credit (section 50).
5. Recapture of low-income housing credit (section 42(j)(4)(D)).
6. Recapture of Indian employment credit (section 45A).

IC-DISC or FSC

A corporation cannot take the American Samoa economic development credit for any tax year it is an IC-DISC or former IC-DISC, or for any tax year in which it owns stock in an IC-DISC or FSC, or former IC-DISC or former FSC (section 936(f)).

Alternative Minimum Tax

Income eligible for the American Samoa economic development credit is not taxed under the alternative minimum tax rules. See Form 4626, Alternative Minimum Tax—Corporations.

Source of Gross Income, etc.

See sections 638, 861-864, and 936 to determine if the source of gross income, deductions, and taxable income is in or outside American Samoa. Amounts received in American Samoa may be considered sourced outside American Samoa if they are from sources outside American Samoa and received from an unrelated person in the active conduct of a trade or business. See section 936(b).

Qualified Production Activities Income (QPAI)

Note. For tax years beginning in 2012, the corporation does not report its QPAI on Form 5735. However, the corporation must have positive QPAI in order to qualify for the American Samoa economic development credit. For tax years beginning in 2012, corporations should calculate their QPAI and keep it for their records in order to prove to the IRS (in the case of an audit) that they qualify for the credit.

Figuring QPAI. QPAI is the excess (if any) of:

1. Domestic production gross receipts (DPGR), over
2. The sum of:
 - a. Cost of goods sold allocable to DPGR, and
 - b. Other expenses, losses, or deductions which are properly allocable to DPGR.

Oil-related qualified production activities income.

Oil-related qualified production activities income is QPAI attributable to the production, refining, processing, transportation, or distribution of oil or gas, or any primary product from oil or gas (section 927(a)(2)(C), as in effect before its repeal).

Primary products from oil. Primary products from oil are crude oil and all products derived from the destructive distillation of crude oil, including volatile products, light oils such as motor fuel and kerosene, distillates such as naphtha, lubricating oils, greases and waxes, and residues such as fuel oil.

A product or commodity derived from shale oil, which would be a primary product from oil if derived from crude oil, is considered a primary product from oil.

Primary products from gas. Primary products from gas are all gas and associated hydrocarbon components from gas or oil wells, whether recovered at the lease or upon further processing, including natural gas, condensates, liquefied petroleum gases such as ethane, propane, and butane, and liquid products such as natural gasoline.

See Temporary Regulations section 1.927(a)-1T(g)(2) for additional information.

Domestic Production Gross Receipts (DPGR)

Generally, your gross receipts (defined later) derived from the following activities are DPGR.

1. Construction of real property you perform in American Samoa in your construction trade or business.

2. Engineering or architectural services you perform in American Samoa in your engineering or architectural services trade or business for the construction of real property in American Samoa.

3. Any lease, rental, license, sale, exchange, or other disposition of the following.

a. Qualifying production property you manufacture, produce, grow or extract in whole or in significant part in American Samoa. See *Qualifying Production Property and Manufacturing, Producing, Growing, or Extracting*, below, for details.

b. Any qualified film you produce.

c. Electricity, natural gas, or potable water you produce in American Samoa.

In general, gross receipts derived from the following activities are not DPGR.

- Activities not attributable to the actual conduct of a trade or business.
- The sale of food and beverages you prepare at a retail establishment.
- The lease, rental, or license of property between certain persons treated as a single employer.
- The lease, rental, license, sale, exchange, or other disposition of land.
- The transmission or distribution of electricity, natural gas, or potable water.
- Advertising and product-placement; however, see Regulations section 1.199-3(i)(5)(ii) for exceptions.
- Customer and technical support, telephone and other telecommunications services, online services (including Internet access services, online banking services, providing access to online electronic books, newspapers, and journals) and other similar services; however, see Regulations section 1.199-3(i)(6)(iii) for exceptions.

Gross receipts. Gross receipts include the following amounts from your trade or business activities.

- Total sales (net of returns and allowances).
- Amounts received for services, not including wages received as an employee.
- Income from incidental or outside sources (including sales of business property).

Gross receipts are generally not reduced by the:

- Cost of goods sold, or
- Adjusted basis of property (other than capital assets) sold or otherwise disposed of, if such property is described in section 1221(a)(1) through (5).

Allocation of gross receipts. You generally must allocate your gross receipts between DPGR and non-DPGR. Allocate gross receipts using a reasonable method that accurately identifies gross receipts that are DPGR. However, if less than 5% of your gross receipts are non-DPGR, you can treat all of your gross receipts as DPGR. Also, if less than 5% of your gross receipts are DPGR, you can treat all of your gross receipts as non-DPGR.

For details, see Regulations section 1.199-1(d).

Qualifying Production Property

The following are qualifying production property.

- Tangible personal property.
- Computer software.
- Sound recordings.

Tangible personal property. Tangible personal property includes any tangible property other than land, buildings (including structural components), computer software, sound recordings, qualified films, electricity, natural gas, or potable water. Tangible personal property also includes any gas (other

than natural gas), chemical, and similar property, such as steam, oxygen, hydrogen, or nitrogen.

Machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs that are contained in or attached to a building constitute tangible personal property.

Note. Local law does not control whether property is tangible personal property.

See Regulations section 1.199-3(j)(2) for more information.

Computer software. In general, computer software includes the following:

- Any program, routine, or sequence of machine-readable code that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe or maintain that program or routine. An electronic book online or for download does not constitute computer software.
- Machine-readable code for (a) video games or similar programs, (b) equipment that is an integral part of other property, and (c) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, even if the program is not designed to operate on a computer as defined in section 168(i)(2)(B).
- Computer programs including, but not limited to, operating systems, executive systems, monitors, compilers and translators, assembly routines, utility programs, and application programs.
- Any incidental and ancillary rights that are necessary for the acquisition of the title to, the ownership of, or the right to use computer software, and that are used only in connection with that specific software. These incidental and ancillary rights are not included in the definition of a trademark or trade name under Regulations section 1.197-2(b)(10)(i).

Exception. Computer software does not include any data or information base unless the data or information base is in the public domain and is incidental to a computer program.

Example. If a word processing program includes a dictionary feature that may be used to spell-check a document, then the entire program (including the dictionary feature) is a computer software program regardless of the form in which the dictionary feature is maintained or stored.

See Regulations section 1.199-3(j)(3) for more information.

Sound Recordings. Sound recordings include any works that result from the fixation of a series of musical, spoken, or other sounds. The definition of sound recordings is limited to the master copy of the recordings (or other copy from which the holder is licensed to make and produce copies), and if the medium (such as compact discs, tapes, or other phonorecordings) in which the sounds may be embodied is tangible, then the medium is considered tangible personal property.

Exception. Sound recordings do not include the creation of copy-righted material in a form other than a sound recording, such as lyrics or music composition.

See Regulations section 1.199-3(j)(4) for more information.

Qualified film. A qualified film is any motion picture film, video tape, or live or delayed television programming, for which 50% or more of the total compensation required to produce the film is paid for services performed by actors, production personnel, directors, and producers in American Samoa.

A qualified film includes the copyrights, trademarks, or other intangibles related to the film. Also, QPAI includes gross receipts from the production of a qualified film regardless of the methods and means by which the film is distributed.

See section 199(c)(6) and Regulations section 1.199-3(k) for more information.

Manufacturing, Producing, Growing, or Extracting

Manufacturing, producing, growing, and extracting (MPGE) generally include the following trade or business activities.

- Activities related to manufacturing, producing, growing, extracting, installing, developing, improving, and creating qualifying production property.
- Making qualifying production property out of scrap, salvage, or junk material, or from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles.
- Cultivating soil, raising livestock, fishing, and mining minerals.
- Storage, handling, or other processing activities (other than transportation activities) in American Samoa related to the sale, exchange, or other disposition of agricultural products, provided the products are consumed in connection with, or incorporated into, manufacturing, producing, growing, or extracting qualifying production property whether or not by the taxpayer.

For details, see Regulations section 1.199-3(e).

Cost of Goods Sold

Cost of goods sold is a component of QPAI and it includes the:

- Cost of goods sold to customers, and
- Adjusted basis of non-inventory property you sold or otherwise disposed of in your trade or business.

Allocation of cost of goods sold. Generally, you must allocate your cost of goods sold between DPGR and non-DPGR using a reasonable method. If you use a method to allocate gross receipts between DPGR and non-DPGR, the use of a different method to allocate cost of goods sold will not be considered reasonable, unless it is more accurate. However, if you qualify to use the small business simplified overall method, you can use it to apportion both cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR.

For details, see Regulations section 1.199-4.

Form W-2 wages. To determine the amount of Form W-2 wages to include in cost of goods sold, see *Wage expense included in cost of goods sold*, later.

Other Deductions, Expenses, or Losses

Other deductions, expenses, or losses include all deductions, expenses, or losses (other than cost of goods sold and employee business expenses) from a trade or business.

Allocation and apportionment of other deductions, expenses, or losses. You can generally use one of the following three methods to allocate and apportion other trade or business deductions, expenses, or losses between DPGR and non-DPGR.

- Small business simplified overall method.
- Simplified deduction method.
- Section 861 method.

However, do not allocate and apportion a net operating loss deduction or deductions not attributable to the conduct of a trade or business to DPGR under any of the methods.

Small Business Simplified Overall Method

You generally can use the small business simplified overall method to apportion cost of goods sold and other deductions, expenses, and losses between DPGR and non-DPGR if you meet any of the following tests.

- You are engaged in the trade or business of farming and are not required to use the accrual method of accounting (see section 447).
- Your average annual gross receipts (defined below) are \$5 million or less.
- You are eligible to use the cash method of accounting under Rev. Proc. 2002-28. You can find Rev. Proc. 2002-28 on page 815 of I.R.B. 2002-18 at www.irs.gov/pub/irs-irbs/irb02-18.pdf.

Under the small business simplified overall method, your total cost of goods sold and other deductions, expenses, and losses are ratably apportioned between DPGR and non-DPGR based on relative gross receipts.

Example. Your total cost of goods sold and other trade or business deductions, expenses, or losses are \$400 and do not include a net operating loss deduction. You have \$1,000 total gross receipts and \$750 DPGR. Your DPGR equal 75% of your total gross receipts. Under the small business simplified overall method, you subtract \$300 ($\$400 \times .75$) of your total cost of goods sold and other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI, which is \$450 ($\750 minus $\$300$).

Average annual gross receipts. For this purpose, your average annual gross receipts are your average annual gross receipts for the preceding 3 tax years. If your business has not been in existence for 3 tax years, base your average on the period it has existed. Include any short tax years by annualizing the short tax year's gross receipts by (a) multiplying the gross receipts for the short period by 12 and (b) dividing the result by the number of months in the short period.

Oil-related production activities. If you have oil-related qualified production activities income and you choose to use the small business simplified overall method, you must allocate part of these costs to DPGR from oil-related production activities to determine oil-related QPAI.

Simplified Deduction Method

You generally can use the simplified deduction method to apportion other deductions, expenses, and losses (but not cost of goods sold) between DPGR and non-DPGR if you meet either of the following tests.

- Your total trade or business assets at the end of your tax year are \$10 million or less.
- Your average annual gross receipts (defined above) are \$100 million or less.

Under the simplified deduction method, your other trade or business deductions, expenses, or losses are ratably apportioned between DPGR and non-DPGR based on relative gross receipts.

Example. Your total other trade or business deductions, expenses, or losses are \$400 and do not include a net operating loss. You have \$240 of cost of goods sold allocable to DPGR. You have \$1,000 total gross receipts and \$600 DPGR. Your DPGR equal 60% of your total gross receipts. Under the simplified deduction method, you subtract \$240 ($\$400 \times .60$) of your total other trade or business deductions, expenses, or losses from your DPGR to figure your QPAI, which is \$120 ($\600 minus $\$240$ minus $\$240$).

Oil-related production activities. If you have oil-related qualified production activities income and you choose to use the simplified deduction method, you must allocate part of these costs to DPGR from oil-related production activities to determine oil-related QPAI.

Section 861 Method

You do not have to meet any tests to use the section 861 method. Under the section 861 method, you generally must apply the rules of the section 861 regulations to allocate and apportion other trade or business deductions, expenses, or losses between DPGR and non-DPGR. Section 199 is treated as an “operative section” described in Regulations section 1.861-8(f).

For details, see Regulations section 1.199-4(d).

For guidance on automatic approval to change certain elections relating to the apportionment of interest expense and research and experimentation expenditures, see Rev. Proc. 2006-42. You can find Rev. Proc. 2006-42 on page 931 of I.R.B. 2006-47 at www.irs.gov/pub/irs-irbs/irb06-47.pdf.

Oil-related production activities. If you have oil-related qualified production activities income, apply the rules of section 861 to determine the amount of other trade or business deductions, expenses, or losses to deduct for purposes of determining oil-related QPAI.

Figuring Form W-2 Wages

You figure Form W-2 wages in two steps. First, you must determine the amount of wages to classify as Form W-2 wages under Regulations section 1.199-2(e)(1). Second, you must figure Form W-2 wages that are properly allocable to DPGR.

You can figure Form W-2 wages that are properly allocable to DPGR using one of the safe harbor methods discussed under *Form W-2 Wages Allocable to DPGR*, below. Also, you can use any reasonable method based on all the facts and circumstances.

You can use one of the following three methods to determine the amount of wages to classify as Form W-2 wages under Regulations section 1.199-2(e)(1).

- Unmodified box method.
- Modified box 1 method.
- Tracking wages method.

Relevant Forms W-2. To figure your Form W-2 wages, generally use the sum of the amounts you properly report for each employee on Form W-2, Wage and Tax Statement, for the calendar year ending with or within your tax year. However, do not use any amounts reported on a Form W-2 filed with the Social Security Administration more than 60 days after its due date (including extensions).

Non-duplication rule. Amounts that are treated as Form W-2 wages for a tax year under any method cannot be treated as Form W-2 wages for any other tax year. Also, an amount cannot be treated as Form W-2 wages by more than one taxpayer.

Unmodified box method. Under the unmodified box method, Form W-2 wages are the **smaller** of:

1. The sum of the amounts reported in box 1 of the relevant Forms W-2, or
2. The sum of the amounts reported in box 5 of the relevant Forms W-2.

Modified box 1 method. Under the modified box 1 method, Form W-2 wages are figured as follows.

1. Add the amounts reported in box 1 of the relevant Forms W-2.
2. Add all the amounts described below and included in box 1 of the relevant Forms W-2.
 - a. Amounts not considered wages for federal income tax withholding purposes.

- b. Supplemental unemployment compensation benefits.
 - c. Sick pay or annuity payments from which the recipient requested federal income tax withholding.
3. Subtract (2) from (1).
 4. Add together any amounts reported in box 12 of the relevant Forms W-2 that are properly coded D, E, F, G, or S.
 5. Add (3) and (4).

Tracking wages method. Under the tracking wages method, Form W-2 wages are figured as follows.

1. Add the amounts reported in box 1 of the relevant Forms W-2 that are also wages for federal income tax withholding purposes.
2. Add any amounts reported in box 1 of the relevant Forms W-2 that are both:
 - a. Wages for federal income tax withholding purposes, and
 - b. Supplemental unemployment compensation benefits.
3. Subtract (2) from (1).
4. Add together any amounts reported in box 12 of the relevant Forms W-2 that are properly coded D, E, F, G, or S.
5. Add (3) and (4).

Form W-2 wages paid to produce a qualified film. Form W-2 wages include compensation for services performed in American Samoa by actors, production personnel, directors, and producers to produce a qualified film. See *Qualified film*, earlier, for more information.

Form W-2 Wages Allocable to DPGR

After you calculate Form W-2 wages, as discussed above, you must figure Form W-2 wages that are properly allocable to DPGR.

You can figure Form W-2 wages that are properly allocable to DPGR under one of the following methods.

- Small business simplified overall method safe harbor.
- Wage expense safe harbor.
- Any other reasonable method based on all the facts and circumstances.

Small business simplified overall method safe harbor. If you use the small business simplified overall method to allocate costs between DPGR and non-DPGR (see *Small Business Simplified Overall Method*, earlier), you can use the small business simplified overall method safe harbor to determine the amount of Form W-2 wages allocable to DPGR. Under this safe harbor method, the amount of Form W-2 wages that is properly allocable to DPGR equals the proportion of DPGR to total gross receipts.

Wage expense safe harbor. If you are using either the section 861 method of cost allocation under Regulations section 1.199-4(d) or the simplified deduction method under Regulations section 1.199-4(e), you determine the amount of wages properly allocable to DPGR by multiplying the amount of wages for the tax year by the ratio of your wage expense included in calculating QPAI for the tax year to your total wage expense used in calculating your taxable income (or adjusted gross income) for the tax year without regard to any wage expenses disallowed by sections 465, 469, 704(d), or 1366(d).

If you use the section 861 method or the simplified deduction method, you must use the same expense allocation and apportionment methods that you use to determine QPAI to allocate and apportion wage expense for purposes of the safe harbor.

Wage expense included in cost of goods sold. After you determine the amount of wages under the wage expense safe harbor, discussed earlier, you can allocate a portion of those wages to cost of goods sold by any reasonable method based on the facts and circumstances. For example, you can include wage expense in cost of goods sold in proportion to (a) the amount of direct labor included in cost of goods sold, or (b) section 263A labor costs (as defined in Regulations section 1.263A-1(h) (4)(ii)) included in cost of goods sold. See Regulations section 1.199-2(e)(2)(ii)(B) for more information.

More information. For more information on figuring your Form W-2 wages, see Regulations section 1.199-2 and Rev. Proc. 2006-47. You can find Rev. Proc. 2006-47 on page 869 of I.R.B. 2006-45 at www.irs.gov/pub/irs-irbs/irb06-45.pdf.

For more information on figuring Form W-2 wages properly allocable to DPGR, see Regulations section 1.199-2(e)(2).

Specific Instructions

Note. Any wages or other expenses taken into account in determining the American Samoa economic development credit may not be taken into account in determining the research credit under section 41.

Line 1

Enter 60% of the sum of:

- The aggregate amount of the corporation's qualified wages for the tax year and
- The allocable employee fringe benefit expenses of the corporation for the tax year.

Qualified wages. Qualified wages are wages paid or incurred by the corporation during the tax year in connection with the active conduct of a trade or business in American Samoa to an employee for services performed in American Samoa, but only if the services are performed while the employee's principal place of employment is in American Samoa.

The term "wages" generally means wages as defined in section 3306(b), but without regard to any dollar limitation contained in that section. For this purpose, section 3306(b) is applied as if the term "United States" includes American Samoa. See section 936(i)(1)(D)(ii) for a special rule for agricultural labor and railway labor.

The wages that are taken into account for the tax year for any employee are limited to 85% of the old-age, survivors, and disability insurance (OASDI) contribution and benefit base for the calendar year in which that tax year begins. The OASDI contribution and benefit base for 2012 is \$110,100 and for 2013 is \$113,700.

Special rules apply to part-time employees and employees whose principal place of employment with the corporation is not within American Samoa at all times during the tax year.

For more information, see section 936(i)(1).

Allocable employee fringe benefit expenses. The total amount of employee fringe benefit expenses taken into account in figuring the economic-activity limitation is the amount deductible by the corporation in the tax year for:

- Employer contributions to stock bonus, pensions, profit-sharing, or annuity plans,
- Employer-provided health or accident plan coverage for the employees, and
- The cost of life or disability insurance provided to employees.

Note. Any amount treated as qualified wages may not be treated as an employee fringe benefit expense.

The amount of allocable employee fringe benefit expenses for a tax year is equal to the total amount of employee fringe benefit expenses (defined above) multiplied by a fraction. The fraction consists of the corporation's qualified wages (defined above) for the tax year, divided by the aggregate amount of wages paid or incurred by the corporation during the tax year.

The allocable employee fringe benefit expenses cannot exceed 15% of the corporation's qualified wages for the tax year.

For more information, see section 936(i)(2).

Lines 2–4

Qualified tangible property means any tangible property used by the corporation in the active conduct of a trade or business within American Samoa.

Short-life qualified tangible property is qualified tangible property that is 3-year or 5-year property under section 168.

Medium-life qualified tangible property is qualified tangible property that is 7-year or 10-year property under section 168.

Long-life qualified tangible property is qualified tangible property that is not short-life or medium-life qualified tangible property.

For more information, see section 936(i)(4).

Note. In the case of any qualified tangible property to which section 168 (as in effect before the date of enactment of the Tax Reform Act of 1986) applies, any references above to section 168 are to that Code section as then in effect.

For more information on depreciation, see the Instructions for Form 4562 and Publication 946.

Line 7

Include the line 7 credit on your income tax return on the same line on which the qualified electric vehicle (QEV) credit is reported. Enter "Form 5735" and the amount next to the entry space for that line. On the 2012 Form 1120, the QEV is reported on Schedule J, line 5b. The credit must also be included on the QEV line of the following forms as applicable: Form 3800, Form 6478, Form 8835, Form 8860, Form 8910, Form 8911, and Form 8912.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. 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 not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 7 hr., 53 min.; **Learning about the law or the form**, 2 hr., 17 min.; and **Preparing, copying, assembling, and sending the form to the IRS**, 2 hr., 32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.