

## 2007 Form 1116, Foreign Tax Credit and Instructions

**Purpose:** This is the first circulated draft of the 2007 Instructions for Form 1116 and a second circulated draft of the Form 1116 for your review and comments. See below for a discussion of the major changes made to the form since the first circulation. See the next page for major changes to the instructions.

**TPCC Meeting:** None, but may be arranged if requested.

**Prior Version:** The 2006 Instructions for Form 1116 are available at:

<http://www.irs.gov/pub/irs-pdf/i1116.pdf>

**Form:** The first circulation of Form 1116 was posted on April 16, 2007 and is available at:

[http://taxforms.web.irs.gov/Products/Drafts/2007-2/07f1116\\_d1.pdf](http://taxforms.web.irs.gov/Products/Drafts/2007-2/07f1116_d1.pdf)

**Other Products:** Circulations of draft tax forms, instructions, notices, and publications are posted at:

[http://taxforms.web.irs.gov/draft\\_products.html](http://taxforms.web.irs.gov/draft_products.html)

**Comments:** Please email, fax, call, or mail any comments to the TLS below and Reviewer, Mark Richter at [mark.e.richter@irs.gov](mailto:mark.e.richter@irs.gov) by **August 31, 2007**.

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### Major Changes to the 2007 Form 1116

Page 1, above Part I

- We changed passive income to passive category income and general limitation income to general category income to match the wording in the code.
- We moved the general category income box up to b and the lump-sum distribution box from b to e. The general category income basket is an official basket and should be listed before the three exceptions.

Page 2

- Line 19, caution- we changed separate category b to e due to the ordering of the boxes on page 1.
- We switched the order of credits- lump-sum distributions is switched from 23 to 25 and general category income is switched from 25 to 23 due to the ordering of the boxes on page 1.

## Description of Major Changes for the 2007 Instructions for Form 1116

### Page 1

- We updated What's New
- 1. To highlight the elimination of certain foreign source income categories per P.L. 108-357, sec 404.
- 2. To add a discussion regarding the carryforward of unused foreign taxes from the eliminated categories per P.L. 108-357, sec. 404
- 3. To highlight the recharacterization of overall domestic loss per P.L. 108-357, sec. 402.
- Middle column, 1<sup>st</sup> bulleted item-we deleted "(b) income that would be passive except that it is also described in another category." IRC 904(d)(2)(B)(iii) and IRC 904(k)(3)(A)(i) as amended by P.L. 108-357, sec. 404.

### Pages 3-4

- We revised the discussion under *Categories of Income* to reflect the elimination of certain foreign source income categories and the renaming of passive income to passive category income and general limitation category to general category income. Per P.L. 108-357, sec. 404.
- We revised the discussion of passive category income to include passive income and specified passive category income per P.L. 108-357, sec. 404.
- We reordered the discussion of the baskets to conform to the reordering of the baskets on Form 1116: The general category income basket is an official basket and should be listed before the three exceptions-Section 901(j) income, Certain income re-sourced by treaty and Lump-sum distributions.

### Pages 6-7

- Under *Foreign Qualified Dividends and Capital Gains (Losses)* we added references through out the discussion to reflect that if taxpayers qualify for the adjustment exception, they can make an election not to make the adjustment and if they do, they must elect not to adjust any of their foreign source qualified dividends or capital gains. Reg sec 1.904(b)-1(b)(3).
- Under *Adjustment Exception*, we updated the dollar amounts for 1040 filers, 1040NR filers and Schedule D filers to reflect the inflation adjustments per Rev Proc 2006-53.

### Page 13

- Column 2, in the *Example*, we changed the last sentence to tell taxpayers who complete 2 or more Forms 1116 to complete Part IV on the Form 1116 with the largest amount entered on line 21. This change was recommended by the LMSB Globalization Strategy & Policy office.
- Column 3, under *Lines 2 Through 5-Deduction and Losses*, 4<sup>th</sup> bullet, we deleted references to the additional exemption for housing Hurricane Katrina displaced individuals. The exemption applied only to tax years 2005 and 2006 per

P.L. 109-73, sec. 302.

- Column 3, under *Itemized deduction limit*, we revised the amount of the itemized deduction limit per Rev. Proc 2006-53. We also revised the reference to the line on the itemized deduction worksheet (line 11) that has the overall reduction. We made the same change in the example that follows.

#### **Page 14**

- Column 1, under *Line 3a*, we added General Sales tax to the bulleted list. The deductibility of this tax was extended per P.L. 109-432, sec 103.
- Column 2, under *Line 4a*, we added “qualified mortgage insurance premiums” to the discussion regarding deductible home mortgage interest per P.L. 109-432, sec. 419.

#### **Page 15**

Column 1, 1<sup>st</sup> full paragraph- we added a discussion regarding the special rule for carrying forward foreign tax credits that were in one of the eliminated baskets. CC:INTL is working on rules for carrybacks to 2006, which we plan to cover in these instructions. IRC 904(d)(2)(K)

#### **Pages 16-17**

Page 16, Column 3 under *Line 17*, we deleted references to the additional exemption for housing Hurricane Katrina displaced individuals. The exemption applied only to tax years 2005 and 2006 per P.L. 109-73, sec. 302.

We also deleted the references in the Worksheet for Line 17 on page 17.

#### **Pages 17-18**

- Under *Adjustment exception*, we added references through out the discussion to reflect that if taxpayers qualify for the adjustment exception, they can make an election not to make the adjustment, and if they do, they must elect not to adjust any of their qualified dividends or capital gains. Reg sec. 1.904(b)-1(b)(3)
- Under *Adjustment exception*, we updated the dollar amounts for 1040 filers, 1040NR filers and Schedule D filers to reflect the inflation adjustments per Rev Proc 2006-53.
- Page 18, 3<sup>rd</sup> column, 1<sup>st</sup> full paragraph- we changed the last sentence to tell taxpayers who complete 2 or more Forms 1116 to complete Part IV on the Form 1116 with the largest amount entered on line 21. This change was recommended by the LMSB Globalization Strategy & Policy office.

2007

Department of the Treasury  
Internal Revenue Service

# Instructions for Form 1116

## Foreign Tax Credit (Individual, Estate, or Trust)

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

### General Instructions

#### What's New for 2007

**Income categories eliminated.** The following categories of income have been eliminated for purposes of computing the foreign tax credit limit. Income that previously fell in these categories is either passive category income or general category income.

- High withholding tax interest.
- Financial services income.
- Shipping income.
- Dividends from a domestic international sales corporation (DISC) or former DISC.
- Certain distributions from a foreign sales corporation (FSC) or former FSC.

High withholding tax interest and shipping income are passive category income or general category income, depending on the circumstances. Financial services income is general category income if you are predominantly engaged in the active conduct of a banking, insurance, financing or similar business. Dividends from a DISC or former DISC and certain distributions from a FSC or former FSC are passive category income.

**Carryforward of unused foreign taxes.** A special rule applies when you carry forward unused foreign taxes that were in the eliminated income categories to a tax year beginning after 2006. See the instructions for line 10.

#### Tax Help

For more information about, or assistance with figuring, the foreign tax credit, the following IRS resources are available.

<b>IRS Contacts</b>	<ul style="list-style-type: none"> <li>• Call 1-800-829-1040 (in U.S. and Puerto Rico).</li> <li>• Call 215-516-2000 (overseas) (not toll free).</li> <li>• Contact IRS offices at U.S. embassies in London, Paris, or the U.S. consulate in Frankfurt.</li> <li>• Write to Internal Revenue Service, International Section, P.O. Box 920, Bensalem, PA 19020-8518.</li> </ul>
<b>Publications</b>	<ul style="list-style-type: none"> <li>• Pub. 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.</li> <li>• Pub. 514, Foreign Tax Credit for Individuals.</li> <li>• Pub. 519, U.S. Tax Guide for Aliens.</li> <li>• Pub. 570, Tax Guide for Individuals With Income From U.S. Possessions.</li> <li>• Pub. 575, Pension and Annuity Income.</li> </ul>

**Recharacterization of overall domestic loss.** If you have an overall domestic loss for any tax year beginning after 2006, you must recharacterize a portion of your U.S. source taxable income in succeeding years as foreign source taxable income for purposes of the foreign tax credit.

In a tax year you choose to claim the foreign tax credit, the overall domestic loss is the domestic loss for that tax year to the extent it offsets foreign source taxable income for that tax year or for any preceding tax year (in which you chose to claim the foreign tax credit) because of a carryback. If you do not choose to claim the foreign tax credit for a tax year, the overall domestic loss is the domestic loss for that tax year to the extent it offsets foreign source taxable income for any preceding tax year (in which you chose to claim the foreign tax credit) because of a carryback.

### Election To Claim the Foreign Tax Credit Without Filing Form 1116

You may be able to claim the foreign tax credit without filing Form 1116. By making this election, the foreign tax credit limitation (lines 14 through 20 of the form) will not apply to you. This election is available only if you meet all of the following conditions.

- All of your foreign source gross income was "passive category income" (which includes most interest and dividends) (see page 3). However, for this purpose, passive income also includes (a) income subject to the special rule for high-taxed income

described on page 3, and (b) certain export financing interest.

- All the income and any foreign taxes paid on it were reported to you on a qualified payee statement. Qualified payee statements include Form 1099-DIV, Form 1099-INT, Schedule K-1 (Form 1041), Schedule K-1 (Form 1065), Schedule K-1 (Form 1065-B), Schedule K-1 (Form 1120S), or similar substitute statements.
- Your total creditable foreign taxes are not more than \$300 (\$600 if married filing a joint return).

This election is not available to estates or trusts.

If you make this election:

- You cannot carry over to any other year any foreign taxes paid or accrued in a tax year to which the election applies (but carryovers to and from other years are unaffected). See the instructions for line 10 on beginning on page 14.
- You are still required to take into account the general rules for determining whether a tax is creditable. See *Foreign Taxes Eligible for a Credit* and *Foreign Taxes Not Eligible for a Credit* on page 2.
- You are still required to reduce the taxes available for credit by any amount you would have entered on line 12 of Form 1116. See the instructions for Line 12 on page 15.

To make the election, just enter on the foreign tax credit line of your tax return (for example, Form 1040, line 51) the smaller of (a) your total foreign tax or (b) your regular tax (for example, Form 1040, line 44).

### Purpose of Form

**Who should file.** File Form 1116 to claim the foreign tax credit if the election above does not apply and:

- You are an individual, estate, or trust, and
- You paid or accrued certain foreign taxes to a foreign country or U.S. possession.

See *Foreign Taxes Eligible for a Credit* on page 2 to determine if the taxes you paid or accrued qualify for the credit.

Do not use Form 1116 to figure a credit for taxes paid to the U.S. Virgin Islands. Instead, use Form 8689, Allocation of Individual Income Tax to the U.S. Virgin Islands.

**Nonresident aliens.** If you are a nonresident alien, you generally cannot take the credit. However, you may be able to take the credit if:

- You were a resident of Puerto Rico during your entire tax year, or
- You pay or accrue tax to a foreign country or U.S. possession on income from foreign sources that is effectively connected with a trade or business in the United States. But if you must pay tax to a foreign country or U.S. possession on income from U.S. sources only because you are a citizen or a resident of that country or U.S. possession, do not use that tax in figuring the amount of your credit.

See section 906 for more information on the foreign tax credit allowed to a nonresident alien individual.

## Credit or Deduction

Instead of claiming a credit for eligible foreign taxes, you can choose to deduct foreign income taxes. Form 1040 filers choosing to do so would deduct foreign income taxes on Schedule A (Form 1040), Itemized Deductions. Generally, if you take the credit for any eligible foreign taxes, you cannot take any part of that year's foreign taxes as a deduction. However, even if you take the credit for eligible foreign taxes for the year, you can take a deduction for:

- Foreign taxes not allowed as a credit because of boycott provisions.
- Taxes paid to certain foreign countries for which a credit has been denied, as described in item (2) under *Foreign Taxes Not Eligible for a Credit* on this page.
- Taxes on income or gain that are not creditable because you do not meet the holding period requirement, as described in item (3) or (5) under *Foreign Taxes Not Eligible for a Credit* on this page.
- Taxes on income or gain that are not creditable because you have to make related payments, as described in item (4) or (6) under *Foreign Taxes Not Eligible for a Credit* on this page.
- Certain taxes paid or accrued to a foreign country in connection with the purchase or sale of oil or gas extracted in that country, as described in item (8) under *Foreign Taxes Not Eligible for a Credit* on this page.

If you want to change your election to take a deduction instead of a credit, or a credit instead of a deduction, you must do so within a special 10-year limitation period. See Pub. 514 for more information.

## Foreign Taxes Eligible for a Credit

You can take a credit for income, war profits, and excess profits taxes paid or accrued during your tax year to any foreign country or U.S. possession, or any political subdivision (for example, city, state, or province), agency, or instrumentality of the country or possession. This includes taxes paid or accrued in lieu of a foreign or possession income, war profits, or excess profits tax that is otherwise generally imposed. For purposes of the credit, U.S. possessions include Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa.

U.S. citizens living in certain treaty countries may be able to take an additional foreign tax credit for foreign tax imposed on certain items of income from the United States. See *Tax Treaties* in Pub. 514 for details. If this applies to you, use the worksheet near the back of Pub. 514 to help you figure this additional credit.

## Foreign Taxes Not Eligible for a Credit

You cannot take a credit for the following foreign taxes.

1. Taxes paid to a foreign country that you do not legally owe, including amounts eligible for refund by the foreign country. If you do not exercise your available remedies to reduce the amount of foreign tax to what you legally owe, a credit for the excess amount is not allowed.

**Example.** Country X withholds \$25 of tax from a payment made to you. Under the income tax treaty between the United States and Country X, you owe only \$15 and can claim a refund from Country X for the other \$10. Only \$15 is eligible for the foreign tax credit (whether or not you apply for a refund).

2. Taxes imposed by and paid to certain foreign countries. These countries are those designated by the Secretary of State as countries that repeatedly provide support for acts of international terrorism, countries with which the United States does not have diplomatic relations, or countries whose governments are not recognized by the United States. Pub. 514 contains a list of these countries.

3. Foreign taxes withheld on a dividend from a corporation, if you have not held the stock for at least 16 days within the 31-day period that begins 15 days before the ex-dividend date. This required holding period is greater for preferred-stock dividends attributable to periods totaling more than 366 days. See section 901(k)(3) or Pub. 514.

4. Foreign taxes withheld on a dividend to the extent that you have to make related payments on positions in similar or related property.

**Example.** You receive a dividend subject to foreign withholding tax. You are obligated to pay someone else an amount equal to all these dividends you receive. You cannot claim a foreign tax credit for the withholding tax on these dividends.

5. Foreign taxes withheld on income or gain (other than dividends) from property if you have not held the property for at least 16 days within the 31-day period that begins 15 days before the date on which the right to receive the payment arises. See section 901(l) or Pub. 514.

6. Foreign taxes withheld on income or gain (other than dividends) from property to the extent you have to make related payments on positions in similar or related property.

7. Payments of foreign tax that are returned to you in the form of a subsidy.

8. Taxes paid or accrued to a foreign country in connection with the

purchase or sale of oil or gas extracted in that country if you do not have an economic interest in the oil or gas, and the purchase price or sales price is different from the fair market value of the oil or gas at the time of the purchase or sale.

9. Foreign taxes paid or accrued on income for which you are claiming an exclusion on Form 8873, Extraterritorial Income Exclusion. However, see section 943(d) for an exception for certain withholding taxes.

You cannot take a credit for any interest or penalties you must pay.

## Foreign Currency Conversion

Report all amounts in U.S. dollars except where specified otherwise in Part II. If you have to convert from foreign currency, attach a detailed explanation of how you figured the conversion rate.

If you take a credit for taxes paid, the conversion rate is the rate of exchange in effect on the day you paid the foreign taxes (or on the day the tax was withheld). If you receive a refund of foreign taxes paid, the conversion rate is the rate in effect when you paid the taxes, not when you receive the refund.

If you choose to account for foreign income taxes on an accrual basis, you must generally use the average exchange rate for the tax year to which the taxes relate. However, you cannot do so if either of the following apply.

- The foreign taxes are actually paid more than 2 years after the close of the tax year to which they relate.
- The foreign taxes are actually paid in a tax year prior to the year to which they relate.

Accrued foreign taxes not eligible for conversion at the yearly average exchange rate must be converted using the exchange rate on the date of payment of the tax.

**Election to use exchange rate on date paid.** If you have accrued foreign taxes that you are otherwise required to convert using the average exchange rate, you may elect to use the exchange rate in effect on the date the foreign taxes are paid if the taxes are denominated in a foreign currency. Once made, the election applies to the tax year for which made and all subsequent tax years unless revoked with the consent of the IRS. The election is available for tax years beginning after 2004. It must be made by the due date (including extensions) for filing the tax return for the first tax year to which the election applies. Make the election by attaching a statement to the applicable tax return.

**Special rules for a qualified business unit.** If you have a qualified business unit, see Pub. 514 for special rules for converting foreign income and taxes into U.S. dollars. You may have a qualified business unit if you own and operate a business or are self-employed in a foreign country.

## Foreign Tax Credit Redeterminations

If you claim a credit for foreign taxes paid, and you receive a refund of all or part of those taxes in a later year, you must file an amended return reducing the taxes credited by the amount refunded.

If you claim the foreign tax credit based on foreign taxes accrued instead of foreign taxes paid, your credit must be redetermined in any of the following situations.

1. Your accrued taxes when paid differ from the amount you claimed as a credit.
2. You do not pay the accrued taxes within 2 years after the close of the tax year to which they relate.
3. After you pay the accrued taxes, you receive a full or partial refund of them.

For item (2) above, foreign taxes paid more than 2 years after the close of the tax year to which they relate can be taken into account in figuring the foreign tax credit for the year to which they relate. However, the taxes must be converted into dollars at the exchange rate in effect at the time they are paid.

If any of the above situations occurs after you file your return, you must file Form 1040X, Amended U.S. Individual Income Tax Return, or other amended return, to notify the IRS so that your U.S. tax for the year or years affected can be redetermined. Complete and attach to Form 1040X (or other amended return) a revised Form 1116 for the tax year(s) affected. See Temporary Regulations section 1.905-4T(b) for more information.



*If you do not notify the IRS of a foreign tax refund or change in the dollar amount of foreign taxes paid or accrued, you may have to pay a penalty.*

See Pub. 514 for more information.

### Tax years beginning before 1998.

For the rules relating to redetermining U.S. taxes for years beginning before 1998, see Pub. 514.

## Income From Sources Outside the United States

This income generally includes, but is not limited to, the following.

- Compensation for services performed outside the United States.
- Interest income from a payer located outside the United States.
- Dividends from a corporation incorporated outside the United States.
- Gain on the sale of nondepreciable personal property you sold while maintaining a tax home outside the United States, if you paid a tax of at least 10% of the gain to a foreign country.

Special rules apply in determining the source of income from the sale of inventory; sale of depreciable property used in a trade or business; sale of intangible property such as a patent, copyright, or trademark; ocean

activities; and transportation services that begin or end in the United States or a U.S. possession. See Pub. 514 for more information.

**Compensation for labor or personal services as an employee.** If you are an employee and receive compensation for labor or personal services performed both inside and outside the United States, special rules apply in determining the source of the compensation. Compensation (other than fringe benefits) is sourced on a time basis. Fringe benefits (such as housing and education) are sourced on a geographical basis. Or you may be able to use an alternative basis to determine the source. If you use an alternative basis, you may have to check the box on line 1b (discussed on page 13). See Pub. 514 for more information.

## Categories of Income

Use a separate Form 1116 to figure the credit for each category of foreign source income listed above Part I of Form 1116. The following instructions tell you what kind of income to include in each category. For more information, see Pub. 514, Code section 904, and Regulations sections 1.904-4 and 1.904-5.

### a. Passive Category Income

Passive category income consists of passive income and specified passive category income.

Passive category income does not include gain from the sale of inventory or property held primarily for sale to customers in the ordinary course of your trade or business; gain from commodities hedging transactions; and active business gains or losses of producers, processors, merchants, or handlers of commodities.

**Passive income.** Passive income generally includes dividends, interest, royalties, rents, annuities, gain from the sale of property that produces such income or of non-income-producing investment property, and gains from foreign currency or commodities transactions. Capital gains not related to the active conduct of a trade or business are also generally passive income.

Passive income does not include export financing interest, active business rents and royalties, or high-taxed income (see *High-taxed income* on this page.)

#### Specified passive category income.

Dividends from a DISC (domestic international sales corporation) or former DISC to the extent they are treated as foreign source income, taxable income attributable to certain foreign trade income, and certain distributions from a FSC (foreign sales corporation) or former FSC are specified passive category income.

**Look-through rules.** Certain income received or accrued by you as a 10%-or-more U.S. shareholder in a controlled foreign corporation (CFC) is treated as passive category income. For example, Subpart F inclusions, dividends interest, rents, and royalties

from a CFC are treated as passive category income to the extent they are attributable to passive category income of the CFC. See Regulations section 1.904-5 for more information.

### b. General Category Income

General category income is income that is not passive category income or income described in categories c., d., and e., discussed later. General category income may include:

- Wages, salary, and overseas allowances of an individual as an employee.
- Income earned in the active conduct of a trade or business.
- Gains from the sale of inventory or depreciable property used in a trade or business.

**Financial services income.** In general, financial services income is treated as general category income if it is derived by a financial services entity in the active conduct of a banking, insurance, financing, or similar business. You are a financial services entity if you are predominantly engaged in the active conduct of a banking, insurance, financing, or similar business for any taxable year.

If you qualify as a financial services entity because you treat certain items of income as active financing income under Regulations section 1.904-4(e)(2)(i)(Y), you must show the type and amount of each item on an attachment to Form 1116.

**High-taxed income** In some cases, passive income and taxes must be treated as general category income and taxes. Generally, passive income and taxes must be treated as general category income if the foreign taxes you paid on the income (after allocation of expenses) exceed the highest U.S. tax that can be imposed on the income. However, no part of the passive income that is financial services income is treated as high-taxed income. See Regulations section 1.904-4(c) for more information.

### c. Section 901(j) Income

No credit is allowed for foreign taxes imposed by and paid or accrued to certain sanctioned countries. However, income derived from each such country is subject to a separate foreign tax credit limitation. Therefore, you must use a separate Form 1116 for income derived from each such country.

These countries are those designated by the Secretary of State as countries that repeatedly provide support for acts of international terrorism, countries with which the United States does not have diplomatic relations, or countries whose governments are not recognized by the United States. Pub. 514 contains a list of these countries.

If you paid taxes to a country that ceased to be a sanctioned country during the tax year, see Pub. 514 for details on how to figure the foreign tax credit for the period that begins after the end of the sanctions.

**Presidential waiver.** The President of the United States has the authority to

waive the denial of the credit with respect to a sanctioned country if (a) it is in the national interest of the United States and will expand trade and investment opportunities for U.S. companies in such sanctioned country, and (b) the President reports to the Congress, not less than 30 days before the waiver is granted, the intention to grant such a waiver and the reason for such waiver.

**TIP** *Since no credit is allowed for taxes paid to sanctioned countries, you would generally complete Form 1116 for this category only through line 16.*

### d. Certain Income Re-sourced by Treaty

If a sourcing rule in an applicable income tax treaty treats any of the specific types of income described below as foreign source, and you elect to apply the treaty, the income will be treated as foreign source.

- Certain gains (section 865(h)), or
  - Certain income from a U.S.-owned foreign corporation (section 904(h)(10)).
- See Regulations section 1.904-5(m)(7) for an example.

**Important.** You must compute a separate foreign tax credit limitation for any such income for which you claim benefits under a treaty, using a separate Form 1116 for each amount of re-sourced income from a treaty country. Add the amounts from line 21 of each separate Form 1116 and enter the total on line 28 of your summary Form 1116 (that is, the Form 1116 for which you are completing Part IV).

**TIP** *Other types of income that are re-sourced under the terms of an income tax treaty (for example, compensation for services*

*performed in the United States by a U.S. citizen resident in a foreign country) are not subject to a separate foreign tax credit limitation. However, the specific treaty may provide for other restrictions on the amount of income that is re-sourced or the amount of credit that is allowed with respect to foreign tax paid on re-sourced income. See, for example, article 24, paragraph 1, of the treaty between France and the United States.*

### e. Lump-Sum Distributions

You can take a foreign tax credit for taxes you paid or accrued on a foreign source lump-sum distribution from a pension plan. Special formulas may be used to figure a separate tax on a qualified lump-sum distribution for the year in which the distribution is received. See Pub. 575 for more information.

If you are able to elect, and do elect, to figure your U.S. tax on a lump-sum distribution using Form 4972, Tax on Lump-Sum Distributions, a separate foreign tax credit limitation applies. Use a separate Form 1116. On this separate Form 1116, check box e above Part I. Skip Part I. Complete Part II showing only foreign taxes that are attributable to the lump-sum distribution. Then, complete the Worksheet for Lump-Sum Distributions, on page 4, to figure the amounts to enter in Part III.

## Special Rules

### Reporting Foreign Tax Information From Partnerships and S Corporations

If you received a 2007 Schedule K-1 from a partnership or S corporation that includes foreign tax information, use the rules below to report that information on Form 1116.

#### General Information for Partners and S Corporation Shareholders

**Less-than-10% limited partners and certain less-than-10% S corporation shareholders.** If you are a limited partner or an S corporation shareholder who does not actively participate in the management of the S corporation and you own a less-than-10% interest (by value) in the partnership or S corporation, you generally may assign exclusively to the passive category your distributive share of foreign source income and deductions from that partnership or S corporation. See Regulations section 1.904-5(h)(2) for more details and exceptions.

**CAUTION** *This rule takes precedence over the income category rules outlined in the instructions that follow for line 16, codes C and D-F, (or line 14, codes C and D-F) of the Schedule K-1, and the apportionment of deductions rules outlined in the instructions on page 5 for line 16, codes H and I-K, (or line 14 codes H and I-K) of the Schedule K-1.*

#### Reporting amounts on Form 1116.

Include amounts reported to you on Schedule K-1 with any other amounts reportable on Form 1116 using:

- A separate Form 1116 for each category of income.
- A separate column in Part I and a separate line in Part II for each country or possession.

#### Explanation of Certain Line Items on Schedule K-1

**TIP** *In each instance that follows, the first line reference is to the Schedule K-1 for Form 1065 and the second line reference is to the Schedule K-1 for Form 1120S. (The Schedule K-1 for Form 1065-B includes all foreign tax information in box 9 or in an attachment for box 9.)*

#### Line 16, code B, or line 14, code B—Gross income from all sources.

Combine your distributive share of “gross income from all sources” with all of your other gross income and enter the total on line 3e. “Gross income from all sources” is a constant amount (that is, you will enter the same amount on line 3e of all Forms 1116 that you file).

#### Line 16, code C, or line 14, code C—Gross income sourced at partner or shareholder level.

This line includes income from the sale of eligible personal property (most personal property other than inventory, depreciable property, and certain intangible property). See Pub. 514 for details.

## Worksheet for Lump-Sum Distributions

*Keep for Your Records*

- |  |    |  |
|--|----|--|
| 1. Enter the amount from Form 1116, line 8 . . . . .   | 1. |  |
| 2. Enter the sum of the amounts from Form 4972, lines 6 and 12, that are from <b>foreign</b> sources. Also enter this amount on Form 1116, line 16 . . . . .                               | 2. |  |
| 3. Enter the sum of the amounts from Form 4972, lines 6 and 12, that are from <b>all</b> sources (both U.S. and foreign). Also enter this amount on Form 1116, line 17 . . . . .           | 3. |  |
| 4. Divide line 2 by line 3. Enter the result as a decimal (rounded to at least four places) here and on Form 1116, line 18. If line 2 is equal to or more than line 3, enter “1” . . . . . | 4. |  |
| 5. Enter the amount from Form 4972, line 30. Also include this amount on Form 1116, line 19 . . . . .  | 5. |  |
| <b>Caution: Do not include the amount on line 5 above in the tax you enter on line 19 of any other Form 1116 you are filing.</b>   |    |  |
| 6. Multiply line 5 by line 4. Enter the result here and on Form 1116, line 20 . . . . .  | 6. |  |
| 7. Enter the <b>smaller</b> of line 1 or line 6 here and on Form 1116, line 21. To the left of line 21, write “LSD” . . . . .  | 7. |  |



Although all income reported to you on this line of the Schedule K-1 has been apportioned to separate categories of income, you must nevertheless first determine (using the rules below) whether the income on this line is U.S. source income or foreign source income. Then, enter only foreign source income in Part I of each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received from the partnership or S corporation).

Use the following rules to source the income reported to you on this line of the Schedule K-1. If you are a U.S. resident (as defined below), the income is U.S. source income. If you are a nonresident (as defined below), the income is foreign source income.

**U.S. resident.** A U.S. resident is a U.S. citizen or resident alien who does not have a tax home in a foreign country or a nonresident alien who has a tax home in the United States.

**Tax home.** Generally, your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you are permanently or indefinitely engaged to work as an employee or self-employed individual. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work.

**Nonresident.** A nonresident is any person who is not a U.S. resident. U.S. citizens and resident aliens with a foreign tax home will not be treated as nonresidents for a sale of eligible personal property unless a foreign tax of 10% or more was paid or accrued on the gain on the sale (or, in the case of a loss sale, a foreign tax of 10% or more would have been paid had the sale resulted in a gain).

**Note.** To help you with these rules, the partnership or S corporation has specifically identified the following.

- Gains on the sale of eligible personal property for which a foreign tax of 10% or more was paid or accrued.
- Losses on the sale of eligible personal property for which a foreign tax of 10% or more would have been paid had the sale resulted in a gain.

Include foreign source income in Part I of the applicable Form 1116 (that is, the Form 1116 for each category of income provided to you for this line of the Schedule K-1). Do not include in Part I of Form 1116 income that you determined (using the above rules) to be U.S. source income.



If the partnership or S corporation has specifically identified any capital gains or losses or unrecaptured section 1250 gain on this line (Schedule K-1, line 16, code C, or line 14, code C) and you have determined that those gains or losses are foreign source, see Foreign Qualified Dividends and Capital Gains (Losses) on this page before entering

an amount in Part I of Form 1116.

**Line 16, codes D, E, and F, or line 14, codes D, E, and F—Foreign gross income sourced at partnership or S corporation level.** Income reported on this line has already been sourced for you by the partnership or S corporation. The partnership or S corporation has reported this income to you by country and by category of income. Include these amounts in Part I of each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).



You should disregard any information shown on your Schedule K-1 pertaining to gross income attributable to a foreign branch. It is intended only for corporate partners preparing Form 1118.

**Line 16, code G, or line 14, code G—Interest expense.** See the instructions for line 4b on page 14 to allocate and apportion the interest expense shown on this line of Schedule K-1. In applying those instructions, take into account your distributive share of the partnership's or S corporation's gross income (for purposes of the \$5,000 threshold) or your pro rata share of the partnership's or S corporation's assets. However, if you were a limited partner or an S corporation shareholder who did not actively participate in the management of the S corporation and your interest in the partnership or S corporation was less than 10%, see the next paragraph. Include interest expense that you allocate to foreign source income on line 4b of the applicable Form 1116. Do not enter in Part I of Form 1116 any interest expense that you allocate to U.S. source income.

**Less-than-10% limited partners and certain less-than-10% S corporation shareholders.** If you are a limited partner or an S corporation shareholder (who does not actively participate in the management of the S corporation) and you own (directly or indirectly) a less-than-10% interest (by income) in the partnership or S corporation, you may generally allocate your distributive share of interest expense from that partnership or S corporation to foreign or U.S. source income based on your distributive share of the gross foreign or U.S. source income of that partnership or S corporation. The interest expense you allocate to foreign source income generally may be apportioned exclusively to the passive category. However, see Temporary Regulations section 1.861-9T(e)(4) for exceptions.

**Line 16, code H, or line 14, code H—Other expenses.** This line includes expenses (other than interest expense) of the partnership or S corporation that must be allocated and apportioned at the partner or shareholder level (for example, research and experimental expenses).

Combine your distributive share of these expenses with all of your other like expenses, if any, and then allocate and apportion them using the applicable rules (for example, for

research and experimental expenses, the rules under Regulations section 1.861-17(f)).

Include expenses that you allocate to foreign source income on line 2 of the applicable Form 1116. Expenses that you allocate to U.S. source income should not be entered on any line of Part I of Form 1116.

**Line 16, codes I, J, and K, or line 14, codes I, J, and K—Deductions allocated and apportioned at partnership or S corporation level to foreign source income.** The partnership or S corporation has already allocated these expenses to foreign source income and has reported them to you by country and by category of income. Include these amounts on line 2 of each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).



You should disregard any information shown on your Schedule K-1 pertaining to definitely allocable deductions attributable to a foreign branch. It is intended only for corporate partners preparing Form 1118.

**Line 16, codes L and M, or line 14, codes L and M—Total foreign taxes.** The partnership or S corporation has already allocated and apportioned total foreign taxes for you and has reported them to you by country and by category of income. Include these amounts in Part II of each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).

**Line 16, code N, or line 14, code N—Reduction in taxes available for credit.** The partnership or S corporation has already apportioned the reduction in taxes available for credit and has reported it to you by country and by category of income. Include these amounts on line 12 of each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).

## Foreign Qualified Dividends and Capital Gains (Losses)

If you have foreign source qualified dividends or foreign source capital gains (including any foreign source capital gain distributions) or losses, you may be required to make certain adjustments to those amounts before taking them into account on line 1a (qualified dividends and gains) or line 5 (losses).

If you completed the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for your tax return, and are not required to file Schedule D, see *Qualified Dividends and Capital Gain Tax Worksheet (Individuals)*, next, to determine the adjustments you may be required to make. If you completed the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, see *Qualified Dividends Tax Worksheet (Estates and Trusts)*, later, to determine the adjustments you may be required to make. If you are required to file



Schedule D, see *Schedule D Filers*, on page 6, to determine the adjustments you may be required to make.

You can elect not to make the adjustments to your qualified dividends and capital gains if you qualify for the adjustment exception. See *Adjustment exception under Qualified Dividends and Capital Gain Tax Worksheet (Individuals)*, *Qualified Dividends Tax Worksheet (Estates and Trusts)*, and *Schedule D Filers*.

## Qualified Dividends and Capital Gain Tax Worksheet (Individuals)

If you completed the Qualified Dividends and Capital Gain Tax Worksheet in your tax return instructions and you do not have to file Schedule D, you may have to adjust the amount of your foreign source qualified dividends and capital gain distributions.

**Form 1040 filers.** You must adjust the amount of your foreign source qualified dividends and capital gain distributions if both of the following apply:

- Line 7 of the Qualified Dividends and Capital Gain Tax Worksheet is greater than zero.
- Line 17 of the Qualified Dividends and Capital Gain Tax Worksheet is less than line 18 of that worksheet.

**Form 1040NR filers.** You must adjust the amount of your foreign source qualified dividends and capital gain distributions if both of the following apply:

- Line 5 of the Qualified Dividends and Capital Gain Tax Worksheet is greater than zero.
- Line 15 of the Qualified Dividends and Capital Gain Tax Worksheet is less than line 16 of that worksheet.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust your foreign source capital gains or qualified dividends. You make this election by not adjusting these items. If you make this election, you must elect not to adjust **any** of your foreign source qualified dividends or capital gain distributions.

**Adjustment exception for Form 1040 filers.** You qualify for the adjustment exception if you meet both of the following requirements.

1. Line 7 of the Qualified Dividends and Capital Gain Tax Worksheet does not exceed:
  - a. \$195,850 if married filing jointly or qualifying widow(er),
  - b. \$97,925 if married filing separately,
  - c. \$160,850 if single, or
  - d. \$178,350 if head of household.
2. The amount of your foreign source capital gain distributions, plus the amount of your foreign source qualified dividends, is less than \$20,000. For this purpose, ignore any capital gain distributions or qualified dividends you elected to include on Form 4952, line 4g.

**Adjustment exception for Form 1040NR filers.** If you file Form 1040NR, you qualify for the adjustment

exception if you meet both of the following requirements.

1. Line 5 of the Qualified Dividends and Capital Gain Tax Worksheet does not exceed:
  - a. \$195,850 if you checked filing status box 6,
  - b. \$97,925 if you checked filing status box 3, 4, or 5, or
  - c. \$160,850 if you checked filing status box 1 or 2.
2. The amount of your foreign source capital gain distributions, plus the amount of your foreign source qualified dividends, is less than \$20,000.

**How to make adjustments.** To adjust your foreign source qualified dividends or capital gain distributions, multiply your foreign source qualified dividends or capital gain distributions in each separate category by 0.4286. Include the results on line 1a of the applicable Form 1116.



*Do not adjust the amount of any foreign source qualified dividends or capital gain distributions that you elected to include on Form 4952, line 4g.*

**No adjustments required.** If you are not required to adjust the amount of your foreign source qualified dividends or capital gain distributions, or you qualify for the adjustment exception and elect not to adjust these items, include the amount of your foreign source qualified dividends and capital gain distributions in each separate category (without adjustment) on line 1a of the applicable Form 1116.

## Qualified Dividends Tax Worksheet (Estates and Trusts)

If you completed the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, you must adjust the amount of your foreign source qualified dividends if:

- Line 5 of the Qualified Dividends Tax Worksheet is greater than zero, and
- Line 15 of the Qualified Dividends Tax Worksheet is less than line 16 of that worksheet.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust your foreign source qualified dividends. You make this election by not adjusting these dividends. If you make this election, you must elect not to adjust **any** of your foreign source qualified dividends. You qualify for the adjustment exception if:

1. Line 5 of the Qualified Dividends Tax Worksheet does not exceed \$7,650, and
2. The amount of foreign source qualified dividends reported on Form 1041, line 2b(2), is less than \$20,000. For this purpose, ignore any qualified dividends you elected to include on Form 4952, line 4g.

**How to make adjustment.** To adjust your foreign source qualified dividends, multiply your foreign source qualified dividends in each separate category by 0.4286. Include the results on line 1a of the applicable Form 1116.



*Do not adjust the amount of any foreign source qualified dividends that you elected to include on Form 4952, line 4g.*

**No adjustment required.** If you are not required to make adjustments to your foreign source qualified dividends (or you qualify for the adjustment exception and you elected not to adjust these dividends), include your foreign source qualified dividends on line 1a of the applicable Form 1116 without adjustment.

## Schedule D Filers

**Note.** Throughout these instructions, references to Schedule D (Form 1041) are for estates and trusts only.

**Adjustments to foreign qualified dividends.** If you are required to file Schedule D (Form 1040, or Form 1041), you must adjust the amount of your foreign source qualified dividends that you include on line 1a of Form 1116 if one of the following applies to you.

1. You figured your tax using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions, line 7 of that worksheet is greater than zero, and line 17 of that worksheet is less than line 18.
2. You figured your tax using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040NR instructions, line 5 of that worksheet is greater than zero, and line 15 of that worksheet is less than line 16.
3. You figured your tax using Schedule D (Form 1041), line 23 of Schedule D is greater than zero, and line 33 of Schedule D is less than line 34.
4. You figured your tax using the Schedule D Tax Worksheet (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions), line 17 of the Schedule D Tax Worksheet is greater than zero, and line 35 of the Schedule D Tax Worksheet is less than line 36.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust foreign source qualified dividends. You make this election by not adjusting these dividends. If you make this election, you must elect not to adjust **any** of your foreign source qualified dividends. You qualify for the adjustment exception if the amount of your foreign source net capital gain, plus the amount of your foreign source qualified dividends, is less than \$20,000 and one of the following applies to you.

1. Line 7 of the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions or line 17 of the Schedule D Tax Worksheet in the Schedule D (Form 1040) instructions is less than or equal to:
  - a. \$195,850 if married filing jointly or qualifying widow(er),
  - b. \$97,925 if married filing separately,
  - c. \$160,850 if single, or
  - d. \$178,350 if head of household.
2. Line 5 of the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040NR instructions or line 17 of

the Schedule D Worksheet in the Schedule D (Form 1040) instructions is less than or equal to:

- a. \$195,850 if you checked filing status box 6,
- b. \$97,925 if you checked filing status box 3, 4, or 5, or
- c. \$160,850 if you checked filing status box 1 or 2.

3. Line 23 of Schedule D (Form 1041) or line 17 of the Schedule D Tax Worksheet in the Form 1041 instructions is less than or equal to \$7,650.

**Note.** Your foreign source net capital gain is the excess of your net long-term capital gain from foreign sources over your net short-term capital loss from foreign sources. Ignore any long-term capital gains you elected to include on Form 4952, line 4g, in determining your foreign source net capital gain. Ignore any qualified dividends you elected to include on Form 4952, line 4g, in determining the amount of your foreign source qualified dividends.

**How to make adjustment.** To adjust your foreign source qualified dividends, multiply your foreign source qualified dividends in each separate category by 0.4286. Include the results on line 1a of the applicable Form 1116.



*Do not adjust the amount of any foreign source qualified dividends that you elected to include on Form 4952, line 4g.*

**No adjustment required.** If you are not required to adjust your foreign source qualified dividends (or you qualify for the adjustment exception and elect not to adjust these dividends), include on line 1a of Form 1116 the full amount of foreign source qualified dividends without adjustment.

**Adjustments to foreign capital gains and losses.** You must use Worksheet A, Worksheet B, or the instructions for

*Capital Gains and Losses* in Pub. 514 to determine the adjustments you must make to your foreign capital gains or losses. Read the instructions below to see if you qualify to use Worksheet A or Worksheet B. If you do not qualify to use Worksheet A or Worksheet B, use the instructions for *Capital Gains and Losses* in Pub. 514 to determine the adjustments you must make.



*Before you complete Worksheet A or Worksheet B, you must reduce each foreign source long-term capital gain by the amount of that gain you elected to include on Form 4952, line 4g. The gain you elected to include on Form 4952, line 4g, must be entered directly on line 1a of the applicable Form 1116 without adjustment.*

**Worksheet A.** You can use Worksheet A on page 8 to determine the adjustments you must make to your foreign source capital gains or losses if you have foreign source capital gains or losses in no more than two separate categories and any of the following apply.

- You qualify for the adjustment exception discussed earlier under *Adjustments to foreign qualified dividends* under *Schedule D Filers*.
- Line 15 or 16 of Schedule D (Form 1040) (line 14a or 15 of Schedule D (Form 1041)) is zero or a loss.
- You figured your tax using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions and (a) line 3 of that worksheet minus the amount on Form 4952, line 4e, that you elected to include on Form 4952, line 4g, is zero or less, (b) line 7 of that worksheet is zero, or (c) line 17 of that worksheet is equal to or greater than line 18.
- You figured your tax using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040NR instructions and (a) line 3 of that

worksheet is zero, (b) line 5 of that worksheet is zero, or (c) line 15 of that worksheet is equal to or greater than line 16.

- You figured your tax using Schedule D (Form 1041) and (a) line 23 of Schedule D is zero, (b) line 18 of Schedule D minus the amount on Form 4952, line 4e, that you elected to include on Form 4952, line 4g, is zero or less, or (c) line 33 is equal to or greater than line 34.
- You figured your tax using the Schedule D Tax Worksheet (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions) and (a) line 17 is zero, (b) line 9 is zero or less, or (c) line 35 is equal to or greater than line 36.

Complete Worksheet A only once, even if you have capital gains or losses in two separate categories. Keep the completed Worksheet A for your records. Do not file Worksheet A with your tax return.

Capital losses are deductible only up to \$3,000 of ordinary income.

**Worksheet B.** If you do not qualify to use Worksheet A, use Worksheet B on page 9 to determine the adjustments you must make to your foreign source capital gains or losses if:

- You have foreign source capital gains or losses in no more than two separate categories, and
- You did not complete the Unrecaptured Section 1250 Gain Worksheet or the 28% Rate Gain Worksheet in the Schedule D instructions.

Complete Worksheet B only once, even if you have capital gains or losses in two separate categories. Keep the completed Worksheet B for your records. Do not file Worksheet B with your tax return.

Worksheet A (See instructions below)

Keep for Your Records

	Category #1	Category #2
	Specify ► _____	_____
1. Separate category capital gain or (loss) . . . . .	1. _____	_____
2. Foreign source capital gain net income . . . . .		2. _____
3. Capital gain net income . . . . .		3. _____
4. Total U.S. capital loss adjustment . . . . .		4. _____
5. Adjusted separate category capital gain . . . . .		5. _____
6. U.S. capital loss adjustment factor. (For each separate category, divide line 1 by line 2 and round off the result to at least four decimal places.) . . . . .	6. _____	_____
7. U.S. capital loss adjustment. (For each separate category, multiply line 4 by line 6.) . . . . .	7. _____	_____
8. Adjusted separate category capital gain. (For each separate category, subtract line 7 from line 1. Enter the result here and include the result on line 1a of the applicable Form 1116.) . . . . .	8. _____	_____

Instructions for Worksheet A

Line 1. For each separate category for which you have foreign source capital gains or losses, combine your foreign source capital gains and losses in that separate category and enter the result on line 1. Show a loss on line 1 of this worksheet as a negative amount and include the loss on line 5 of the Form 1116 you are filing for that separate category.

Line 2. Combine the amounts entered on line 1. If the result is zero or less, do not complete the rest of the worksheet. Instead, for each separate category with a positive amount on line 1 of this worksheet, include that positive amount on line 1a of the Form 1116 you are filing for that separate category.

Line 3. Enter the amount from line 16 of Schedule D (Form 1040), less the portion of net capital gain you included on Form 4952, line 4g. If the result is zero or less, enter -0-.

Estates and trusts: Enter the amount from line 15 of Schedule D (Form 1041), less any amount shown on line 21 of that Schedule D. If the result is zero or less, enter -0-.

Line 4. Subtract line 3 from line 2 and enter the result on line 4. If the result is zero or less, do not complete the rest of the worksheet. Instead, for each separate category with a positive amount on line 1 of this worksheet, include that positive amount on line 1a of the Form 1116 you are filing for that separate category.

Line 5.

- If both separate categories have a positive amount on line 1, skip line 5 and go to line 6.
- If only one separate category has a positive amount on line 1, subtract line 4 from that positive amount. Enter the result here and include the result on line 1a of the Form 1116 you are filing for that separate category. Skip lines 6–8 of this worksheet.

**Worksheet B** (See instructions below)

*Keep for Your  
Records*

	Category #1 Specify ▶ _____		Category #2 Specify ▶ _____		(5) Other
	(1) Short-Term	(2) Long-Term (15%)	(3) Short-Term	(4) Long-Term (15%)	
1. Separate category rate group capital gain or (loss)					
2. U.S. capital loss adjustment amount					
3. Subtotal (subtract line 2 from line 1 gain amounts)					
4. Net U.S. long-term capital loss					
5. U.S. long-term capital loss adjustment					
6. Excess net U.S. long-term capital loss					
7. Long-term capital gain (or adjustment amount)					
8. Limitation percentage					
9. Long-term limitation amounts					
10. Adjustment amounts					
11. Rate differential adjustments					
12. Long-term gains					
13. Rate differential adjustment					
14. Long-term gain					
15. Adjusted separate category capital gains and losses					

**Instructions for Worksheet B**

**Line 1.** For each separate category:

- Combine your foreign source short-term capital gains and losses and enter the result in column (1) or (3).
- Combine your foreign source long-term capital gains and losses and enter the result in column (2) or (4).

**Line 2.** Complete the Line 2 Worksheet on page 11 for each column on line 1 with a gain.

**Line 4.** Enter your net long-term capital loss (if any) from U.S. sources. To determine this amount, subtract your long-term capital losses from U.S. sources from your long-term capital gains from U.S. sources. Enter the loss (if any) as a positive amount in column (5). If you do not have a loss, leave line 4 blank and skip lines 5 through 14.

**Line 5.** Combine the amounts (if any) from columns (2) and (4) on line 2. Enter the result in column (5). If you do not have any amount entered in either column, enter -0- in column (5).

**Line 6.** Subtract line 5 from line 4. Enter the result in column (5). If the result is zero or less, leave line 6 blank and skip lines 7 through 14 of this worksheet.

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## Line 7.

- If you entered an amount in either column (2) or (4) (but not both) of line 3, subtract line 6 from the amount entered in either column (2) or (4) of line 3. Enter the result in column (2) or (4) on line 7 and skip lines 8 through 12.
- If you entered amounts in both columns (2) and (4) on line 3, combine those amounts and enter the result in column (5) on line 7.

**Line 8.** Divide each amount on line 3 by line 7 and enter the results on line 8. Round off each result to at least four decimal places.

**Line 9.** Multiply each decimal amount on line 8 by line 6 and enter the results in the appropriate columns on line 9.

**Line 10.** Subtract line 9, column (2) from line 3, column (2) and enter the result on line 10, column (2). Subtract line 9, column (4) from line 3, column (4) and enter the result on line 10, column (4).

**Line 11.** Multiply each amount on line 10 by 0.4286 and enter the results here.

**Line 12.** Combine line 11, column (2) with line 9, column (2) and enter the result on line 12, column (2). Combine line 11, column (4) with line 9, column (4) and enter the result on line 12, column (4). Include the amounts on line 1a of the applicable Form 1116. Skip lines 13 and 14.

**Line 13.** Multiply the amount on line 7 by 0.4286 and enter the result here in the applicable column.

**Line 14.** Combine line 6 and line 13 and enter the result here. Include the result on line 1a of the applicable Form 1116.

## Line 15.

If you have a:

- Short-term gain shown in column (1) or (3) of line 3, enter the amount of that short-term gain on line 15, column (1) or (3).
- Long-term gain shown in column (2) or (4) of line 3, and line 6 is blank, multiply the amount of each gain by 0.4286 and enter the result on line 15, column (2) or (4).
- Short-term loss in any column of line 1, complete the Line 15 Worksheet on page 12 for each column with a loss.
- Long-term loss in column (2) or (4) of line 1, multiply the amount of the loss by 0.4286 and enter the result on line 15 in the appropriate column.

After you have completed line 15:

- Include line 15 gain amounts on line 1a of the applicable Form 1116.
  - Include line 15 loss amounts on line 5 of the applicable Form 1116.
-

**Line 2 Worksheet (For Line 2 of Worksheet B)**  
(See instructions below)

*Keep for Your  
Records*

	Category #1	Category #2	
Specify ►			
1. Separate category rate group gain (or loss) . . . . .	1.	1.	
	<b>Short-Term</b>	<b>Long-Term</b>	<b>Short-Term</b> <b>Long-Term</b>
2. Separate category gain (or loss) . . . . .	2.	2.	
3. Foreign source capital gain net income . . . . .			3. <span style="border-bottom: 1px solid black;"></span>
4. Capital gain net income . . . . .			4. <span style="border-bottom: 1px solid black;"></span>
5. Total U.S. capital loss adjustment . . . . .			5. <span style="border-bottom: 1px solid black;"></span>
6. Separate category adjustment . . . . .	6.	6.	
7. Rate Group Factor . . . . .	7.	7.	
8. Rate Group Adjustment . . . . .	8.	8.	

**Instructions for Line 2 Worksheet**

**Line 1.** Enter your gains and losses from line 1 of Worksheet B. Enter a loss as a negative amount (in parentheses).

**Line 2.** For each separate category, combine the amounts from line 1. Enter a loss as a negative amount (in parentheses).

**Line 3.** Combine the amounts from line 2 of this worksheet. If the result is zero or less, stop here. Do not enter any amount on line 2 of Worksheet B.

**Line 4.** Enter the amount from line 16 of the Schedule D (Form 1040), less the portion of net capital gain you included on Form 4952, line 4g. If the amount entered on line 4 is zero or less, stop here. Do not continue with this worksheet or Worksheet B. Instead, complete Worksheet A.

**Estates and trusts:** Enter the amount from line 15 of the Schedule D (Form 1041), less any amount shown on line 21 of that Schedule D. If the amount entered on line 4 is zero or less, stop here. Do not continue with this worksheet or Worksheet B. Instead, complete Worksheet A.

**Line 5.** Subtract line 4 from line 3 and enter the result on line 5. If the result is zero or less, stop here. Do not enter any amount on line 2 of Worksheet B.

**Line 6.**

- If only one separate category has a positive amount on line 2, enter the amount from line 5 on line 6 (in the column for the separate category with the positive amount on line 2).
- If both separate categories have positive amounts on line 2, divide each amount on line 2 by line 3. Multiply each result by line 5. Enter the results on line 6 in the appropriate columns.

**Line 7.**

**For each separate category:**

- If you entered an amount on line 6 and you entered positive amounts in both the short-term and long-term columns on line 1, divide each positive amount on line 1 by line 2 and enter the results in the appropriate columns.
- Leave line 7 blank if you did not enter an amount on line 6 or only one column on line 1 has a positive amount.

**Line 8.**

**For each separate category:**

- If you entered amounts on line 7, multiply each amount on line 7 by line 6. Enter the results in the appropriate columns on line 8 of this worksheet and on line 2 of Worksheet B.
- If line 7 is blank, enter the amount from line 6 in the same column on line 8 as the column that has a gain on line 1. Also, enter the amount on line 2 of Worksheet B in the appropriate column. If line 6 is blank, do not enter any amount on line 8 of this worksheet or line 2 of Worksheet B.

Line 15 Worksheet (For Line 15 of Worksheet B)

Keep for Your Records

- 1. Enter your net short-term capital gain (if any) from U.S. sources. To determine this amount, subtract your short-term capital losses from U.S. sources from your short-term capital gains from U.S. sources. If the result is zero or a loss, enter -0-
2. If you entered a short-term gain on line 3 of Worksheet B, enter that amount here
3. Add lines 1 and 2
4. Did you enter a short-term capital loss on line 1 of Worksheet B for one (but not both) of the separate categories?
5. Enter the short-term capital loss from line 1 of Worksheet B (enter the loss as a positive amount)
6. Enter the gain, if any, determined on line 3. If line 3 is not a gain, enter -0-
7. Subtract line 6 from line 5. If zero or a loss, enter -0-
8. Multiply line 7 by 0.4286
9. Enter the smaller of line 5 or line 6
10. Add lines 8 and 9. Enter the result here and on line 15 of Worksheet B
11. Is the amount on line 1 zero?
12. Enter your short-term loss from Worksheet B, line 1, column (1) (enter the loss as a positive amount)
13. Enter your short-term loss from Worksheet B, line 1, column (3) (enter the loss as a positive amount)
14. Add lines 12 and 13
15. Enter the gain determined in line 1
16. Subtract line 15 from line 14.
17. Multiply line 16 by 0.4286
18. Add lines 15 and 17
19. Divide line 12 by line 14
20. Multiply line 19 by line 18. Enter the result here and on Worksheet B, line 15, column (1)
21. Divide line 13 by line 14
22. Multiply line 21 by line 18. Enter the result here and on Worksheet B, line 15, column (3)

## Specific Instructions

### Part I—Taxable Income or Loss From Sources Outside the United States



Part I must be completed by all filers unless specifically indicated otherwise in these instructions.

#### Line 1—Foreign Country or U.S. Possession

Generally, if you received income from, or paid taxes to, more than one foreign country or U.S. possession, report information on a country-by-country basis on Form 1116, Parts I and II. Use a separate column in Part I and a separate line in Part II for each country or possession. If you paid taxes to more than three countries or possessions, attach additional sheets following the format of Parts I and II.

#### Lines 1a and 1b—Foreign Gross Income

Include income in the category checked above Part I that is taxable by the United States and is from sources within the country entered on line 1. You must include income even if it is not taxable by that foreign country. Identify the type of income on the dotted line next to line 1a. Do not include any earned income excluded on Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.

**Example.** If you received dividends (passive category income) and wages (general category income) from foreign sources, you must complete two Forms 1116. On one Form 1116, check box a (passive category income), enter the dividends on line 1a, and write “Dividends” on the dotted line. On the other Form 1116, check box b (general category income), enter on line 1a wages not excluded on Form 2555 or Form 2555-EZ, and write “Wages” on the dotted line. Complete Parts I, II, and III of each Form 1116. Then, complete Part IV on the Form 1116 with the largest amount entered on line 21.



If you are filing a Form 1116 that includes foreign source qualified dividends or foreign source capital gains or losses, see Foreign Qualified Dividends and Capital Gains (Losses) starting on page 5.

#### Line 1b

You must check the box on line 1b if all of the following apply.

- The income on line 1a is compensation for services you performed as an employee.
- Your total employee compensation from both U.S. and foreign sources was \$250,000 or more.
- You used an alternative basis (discussed in Pub. 514) to determine the source of the compensation entered on line 1a.

In addition, attach to Form 1116 a statement that contains the following information.

- The specific compensation income or the specific fringe benefit for which the alternative basis is used.
- For each such item, the alternative basis of allocation of source used.

- For each such item, a computation showing how the alternative allocation was computed.
- A comparison of the dollar amount of the compensation sourced within and without the U.S. under both the alternative basis and the time or geographical basis for determining the source.

You must keep documentation showing why the alternative basis more properly determines the source of the compensation.

#### Lines 2 Through 5—Deductions and Losses

You must reduce your foreign gross income on line 1a by entering on lines 2 through 5:

- Any of your deductions that definitely relate to that foreign income, and
- A ratable share of your other deductions that do not definitely relate to that foreign income, any other foreign income, or U.S. source income.

Do not include:

- Deductions and losses related to exempt or excluded income, such as foreign earned income you have excluded on Form 2555 or Form 2555-EZ.
- The deduction for personal exemptions.

Special rules apply to the allocation of research and experimental expenditures. See Regulations section 1.861-17.

If the law of a U.S. state to which you pay income taxes does not specifically exempt foreign source income from tax, you may be required to make a special allocation of state taxes you paid. See Pub. 514 for more information.

**Itemized deduction limit.** If you must reduce the total amount of your itemized deductions on line 29 of Schedule A (Form 1040) because your adjusted gross income was more than \$156,400 (\$78,200 if married filing separately), you must reduce each of the itemized deductions that are subject to the reduction by the reduction percentage before you complete lines 2, 3a, and 4a.

Use the Itemized Deductions Worksheet in the Instructions for Schedule A (Form 1040) to figure the reduction percentage. Divide the amount on line 11 of the worksheet (the overall reduction) by the amount on line 3 of the worksheet (total itemized deductions subject to the reduction). This is your reduction percentage. Apply this percentage (expressed as a decimal rounded to at least four places) to each itemized deduction subject to the reduction to determine the amount to enter on the appropriate line of Form 1116.

**Note.** You do not need to make this computation if the entire amount of your itemized deductions is entered on any one of the following lines: line 2, line 3a, or line 4a. Just enter your reduced itemized deductions on that line.

**Example.** You are single and have an adjusted gross income of \$216,400. Your itemized deductions subject to the

### Worksheet for Home Mortgage Interest—Line 4a

Keep for Your Records

**Note:** Before you complete this worksheet, read the instructions for line 4a on page 14.

1. Enter gross foreign source income\* of the type shown on Form 1116. **Do not** enter income excluded on Form 2555 or Form 2555-EZ . . . . . **1.** \_\_\_\_\_
2. Enter gross income from all sources. **Do not** enter income excluded on Form 2555 or Form 2555-EZ . . . . . **2.** \_\_\_\_\_
3. Divide line 1 by line 2 and enter the result as a decimal (rounded to at least four places) . . . . . **3.** \_\_\_\_\_
4. Enter deductible home mortgage interest (from lines 10 through 13 of Schedule A (Form 1040))\*\* . . . . . **4.** \_\_\_\_\_
5. Multiply line 4 by line 3. Enter the result here and on the appropriate Form 1116, line 4a . . . . . **5.** \_\_\_\_\_

\*If you have to report income from more than one country on Form 1116, complete a separate worksheet for each country. Use only the income from that country on line 1 of the worksheet.

\*\*If you were required to reduce the amount of your itemized deductions on Schedule A, enter the reduced amount of home mortgage interest on line 4 of the worksheet.



overall reduction (line 3 of the worksheet) total \$20,000. \$8,000 of these deductions are definitely related to the income on Form 1116, line 1a. The other \$12,000 (\$20,000 – \$8,000) are real estate taxes, which are not definitely related.

The amount of the overall reduction on line 11 of the worksheet is \$1,200. To figure the amount of the real estate taxes to include in the total for line 3a of Form 1116, divide the amount on line 11 (\$1,200) by the amount on line 3 (\$20,000). This is your reduction percentage (6%). You must reduce your \$12,000 deduction by \$720 (6% x \$12,000). The reduced deduction of \$11,280 (\$12,000 – \$720) is the amount to enter on line 3a of Form 1116. Make a similar computation to figure the amount of definitely related itemized deductions (\$7,280) to enter on line 2.

## Line 2



*Before you complete line 2, read Itemized deduction limit on page 13.*

Enter your deductions that definitely relate to the gross income from foreign sources shown on line 1a. For example, if you are an employee reporting foreign earned income on line 1a, include on line 2 expenses such as those incurred to move to a new principal place of work outside the United States or supplies you bought for your job outside the United States.

Do not include any interest expense on line 2. See lines 4a and 4b for special rules for interest expense.

## Lines 3a and 3b

Some deductions do not definitely relate to either your foreign source income or your U.S. source income. Enter on lines 3a and 3b any deductions (other than interest expense) that:

- Are not shown on line 2, and
- Are not definitely related to your U.S. source income.

**Line 3a.** Before you complete line 3a, read *Itemized deduction limit* starting on page 13.

Enter the following itemized deductions (from Schedule A (Form 1040)) on line 3a.

- Medical expenses (line 4)
- General sales tax (line 5)
- Real estate taxes (line 6)

If you do not itemize deductions, enter your standard deduction on line 3a.

**Line 3b.** Enter on line 3b any other deductions that do not definitely relate to any specific type of income (for example, the deduction for alimony paid from Form 1040, line 31a).

## Lines 3d and 3e

For lines 3d and 3e, gross income means income without regard to deductions and losses.

**Line 3d.** Enter your gross foreign source income from the category you checked above Part I of this Form 1116. Include any foreign earned income you have excluded on Form

2555 or Form 2555-EZ but do not include any other exempt income.

If you had income from more than one country, you must enter income from only one country in each column.

If you had to adjust your foreign qualified dividends or capital gains (see page 5), include those amounts without regard to any adjustments.

**Line 3e.** Enter on line 3e in each column your gross income from all sources and all categories, both U.S. and foreign. Include any foreign earned income you have excluded on Form 2555 or Form 2555-EZ but do not include any other exempt income.

If you are a nonresident alien, include on both lines 3d and 3e your income that is not effectively connected with a trade or business in the United States.

If you had to adjust your foreign qualified dividends or capital gains (see page 5), include those amounts without regard to any adjustments.

## Line 3f

Divide line 3d by line 3e and round off the result to at least four decimal places (for example, if your result is 0.8756782, round off to 0.8757, not to 0.876 or 0.88). Enter the result, but do not enter more than “1.”

## Line 4a

If your gross foreign source income (including income excluded on Form 2555 or Form 2555-EZ) does not exceed \$5,000, you can allocate all of your interest expense to U.S. source income. Otherwise, deductible home mortgage interest (including points and qualified mortgage insurance premiums) is apportioned using a gross income method. Use the worksheet on page 13 to figure the amount to enter on line 4a. Before you complete the worksheet, read *Itemized deduction limit* on page 13.

## Line 4b

Other interest expense includes investment interest, interest incurred in a trade or business, and passive activity interest. If you are a U.S. citizen, resident alien, or a domestic estate, and your gross foreign source income (including any income excluded on Form 2555 or Form 2555-EZ) does not exceed \$5,000, you can allocate all of your interest expense to U.S. source income. Otherwise, each type of interest expense is apportioned separately using an “asset method.” See Pub. 514 for more information.

**Example.** You have investment interest expense of \$2,000. Your assets of \$100,000 consist of stock generating U.S. source income (adjusted basis, \$40,000) and stock generating foreign source income (adjusted basis, \$60,000). You apportion 40% (\$40,000/\$100,000) of \$2,000, or \$800 of your investment interest, to U.S. source income and 60% (\$60,000/\$100,000) of \$2,000, or \$1,200, to foreign source income. In this example, you will enter the \$1,200 apportioned to foreign source income on line 4b. You would not enter the \$800 apportioned to U.S.

source income on any line of Part I of Form 1116.

## Line 5

If you have capital losses from foreign sources, see *Foreign Qualified Dividends and Capital Gains (Losses)* starting on page 5 for information on adjustments you may be required to make.

## Part II—Foreign Taxes Paid or Accrued



*See page 2 for descriptions of foreign taxes that are eligible for the foreign tax credit and foreign taxes that are not eligible for the foreign tax credit.*

You can take a foreign tax credit in the tax year you paid or accrued the foreign taxes, depending on your method of accounting. If you report on the cash basis, you can choose to take the credit for accrued taxes by checking the “accrued” box in Part II. But once you choose to do this, you must credit foreign taxes in the year they accrue on all future returns.

Generally, you must enter in Part II the amount of foreign taxes, in both the foreign currency denomination(s) and as converted into U.S. dollars, that relate to the category of income checked above Part I. Taxes are related to the income if the income is included in the foreign tax base on which the tax is imposed. If the foreign tax you paid or accrued relates to more than one category of income, apportion the tax among the categories. The apportionment is based on the ratio of net foreign taxable income in each category to the total net income subject to the foreign tax. See Pub. 514 for an example.

However, if foreign tax paid on passive income is reported to you in U.S. dollars on a Form 1099-DIV, 1099-INT, or similar statement, you do not have to convert the amount shown into foreign currency. This rule applies whether or not you can make the election to claim the foreign tax credit without filing Form 1116 (as explained on page 1). Enter “1099 taxes” in Part II, column (j), and complete columns (o) through (s) for each foreign country indicated in Part I.

**Note.** If you are taking a credit for additional taxes paid or accrued as the result of an audit by a foreign taxing authority or you are filing an amended return reflecting a foreign tax refund, attach a statement to Form 1116 identifying these taxes.

## Part III—Figuring the Credit

### Line 10

You can carry back 1 year and then forward 10 years any foreign tax you paid or accrued to any foreign country or U.S. possession (reduced as described on page 15) on income in a separate category that is more than the

limitation. First, apply the excess to the earliest year to which it may be carried. Then, apply it to the next earliest year, and so on. The carryback-carryforward period cannot be extended even if you are unable to take a credit in one of the intervening years.

A special rule applies when you carry forward taxes that were in the eliminated income categories to a tax year beginning after 2006. Under this rule, the taxes carried forward are treated as paid or accrued on income in the separate category in which the income would have fallen if the taxes were paid or accrued in a tax year beginning after 2006. Thus, assign these taxes to either passive category income or general category income as appropriate.

You cannot carry a credit back to a tax year for which you claimed a deduction, rather than a credit, for foreign taxes paid or accrued. However, you must reduce the amount of any carryback or carryforward by the amount that you would have used had you chosen to claim a credit rather than a deduction in that year.

If, for any year, you elected to claim the foreign tax credit without filing Form 1116 (as explained on page 1), the following rules apply.

- You cannot carry over unused foreign taxes paid or accrued in a year to which the election does not apply to any year for which you made the election.
- The carryback-carryforward period is not extended if you are unable to use a carryback or carryforward because you made the election.
- Do not reduce the carryback or carryforward by the amount you would have used in the election year if you had not made the election.

File Form 1040X or other amended return and a revised Form 1116 for the earlier tax year to which you are carrying back excess foreign taxes.

Special rules apply to the carryback and carryforward of foreign taxes paid or accrued on foreign oil and gas extraction income. See section 907(f).

See Pub. 514 for more information on carryback and carryforward provisions, including examples.

## Line 12

You may have to reduce the foreign taxes you paid or accrued by the following items.

- **Taxes on income excluded on Form 2555 or Form 2555-EZ.** Reduce taxes paid or accrued by the taxes allocable to any foreign earned income excluded on Form 2555 or Form 2555-EZ. If only part of your foreign earned income is excluded, you must determine the amount of tax allocable to excluded income. To do so, multiply the foreign taxes paid or accrued on foreign earned income received or accrued during the tax year by the following fraction.

*Numerator:* Foreign earned income and housing amounts you excluded for the tax year minus otherwise deductible expenses (not including the foreign

housing deduction) allocable to that income.

*Denominator:* Your total foreign earned income received or accrued during the tax year minus deductible expenses (including the foreign housing deduction) allocable to that income. However, if the foreign jurisdiction charges tax on foreign earned income and some other income (for example, earned income from U.S. sources or a type of income not subject to U.S. tax) and the taxes on the other income cannot be segregated, the denominator is the total amount of income subject to foreign tax minus deductible expenses allocable to that income.

See Pub. 514 for a comprehensive example.

- **Taxes on income from Puerto Rico exempt from U.S. tax.** The reduction applies if you have income from Puerto Rican sources that is not taxable on your U.S. tax return. To figure the credit, reduce your foreign taxes paid or accrued by the taxes allocable to the exempt income. See Pub. 570 for more information.

- **Taxes on income from American Samoa excluded from U.S. tax.** If you are a bona fide resident of American Samoa, reduce taxes paid or accrued by any taxes attributable to excluded income from sources in American Samoa. For more information, see Pub. 570.

- **Taxes on foreign-oil-related income.** Reduce taxes paid or accrued by foreign taxes paid or accrued on foreign-oil-related income, but only to the extent the tax imposed by the foreign country on the oil-related income is considered to be materially greater than the tax generally imposed by that country on other kinds of income. See Regulations section 1.907(b)-1. The amount of tax not allowed as a credit under this rule is allowed as a business expense deduction.

- **Taxes on foreign oil and gas extraction income.** Reduce taxes paid or accrued by taxes imposed on foreign oil and gas extraction income. The amount of the reduction is the amount by which your foreign oil and gas extraction taxes exceed the amount of your foreign oil and gas extraction income for the year multiplied by a fraction equal to your pre-credit U.S. tax liability (for example, Form 1040, line 44) divided by your worldwide income. You may be entitled to carry over to other years taxes reduced under this rule. See section 907(f).

- **Taxes on foreign mineral income.** Reduce taxes paid or accrued on mineral income from a foreign country or U.S. possession if you took a deduction for percentage depletion under section 613 for any part of the mineral income.

- **Reduction for failure to file Form 5471.** U.S. shareholders who control a foreign corporation must file Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations. If you do not file Form 5471 and furnish all of the information required by the due date of your tax return, reduce by 10% all

foreign taxes that you otherwise may take into account for the foreign tax credit. You may have to make additional reductions if the failure continues. See section 6038(c) for details and exceptions.

**Note.** The reduction in foreign taxes is reduced by any dollar penalty imposed under section 6038(b).

- **Reduction for failure to file Form 8865.** U.S. partners who control a foreign partnership must file Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. If you do not file Form 8865 and furnish all of the information required by the due date of your tax return, reduce by 10% all foreign taxes that you otherwise may take into account for the foreign tax credit. You may have to make additional reductions if the failure continues. See section 6038(c) for details and exceptions.

**Note.** The reduction in foreign taxes is reduced by any dollar penalty imposed under section 6038(b).

- **Reduction of taxes or credit due to international boycott operations.** In general, if you agree to participate in, or cooperate with, an international boycott, you must file Form 5713, International Boycott Report, and attach all supporting schedules. In addition, you must reduce either the total taxes available for credit or the credit otherwise allowable by your foreign taxes resulting from boycott activities. If you can figure the taxes specifically attributable to boycott operations, enter the amount on line 12. If you cannot figure the amount of taxes specifically attributable to boycott operations, multiply the credit otherwise allowable by the international boycott factor (figured on Schedule A (Form 5713), International Boycott Factor) and enter the result on Form 1116, line 28. Attach a statement to Form 1116 showing in detail how you figured the reduction.

For more information, see Form 5713 and its instructions.

## Line 14

The amount on line 14 is your taxable income (or loss), before adjustments, from sources outside the United States. If the amount on line 14 is zero or a loss, you generally have no foreign tax credit for the category of income checked above Part I of this Form 1116. However, you must complete line 15 and continue with the form even if line 14 is zero or a loss.

## Line 15

You are required to increase or decrease the amount on line 14 by the following adjustments. The adjustments must be made in the order listed. If you have more than one adjustment, enter the net adjustment on line 15 and attach a detailed statement showing your computation. See Pub. 514 for more details on each of these adjustments.

The adjustments are:

1. **Allocation of foreign losses.** If you have a loss on line 14 of one Form 1116 and you have income on line 14 of one or more other Forms 1116, you

must reduce the foreign income by a pro rata share of the loss before you use any remaining loss to reduce U.S. source income.

If the loss reduces foreign source income, you must recharacterize the income you receive in the loss category in later years. See *Recharacterization of income* on this page. In situations where the loss to be allocated exceeds foreign income in other categories, the excess reduces U.S. source income (as modified below under *Capital losses*) and for later years, you must follow the rules described under *Recapture of prior year overall foreign loss* on this page.

**Capital losses.** In determining your U.S. source income, reduce the amount of any capital losses from U.S. sources by the amount you entered on line 4 of Worksheet A or line 5 of the Line 2 Worksheet for Worksheet B. If you have capital losses from U.S. sources and you did not use either Worksheet A or Worksheet B, see Pub. 514 to determine your U.S. source income.

**Example.** For 2007, you completed three Forms 1116. The first had a loss from general category income of \$2,000 on line 14, the second had passive category income of \$4,000 from sources on line 14, and the third had income of \$1,000 from the certain income re-sourced by treaty category on line 14. You must allocate the \$2,000 loss between the passive category income and the certain income re-sourced by treaty category in the same proportion as each category's income bears to the total foreign income.

The amount of the loss that would reduce passive category income would be 80% (\$4,000/\$5,000) of the \$2,000 loss or \$1,600. Include the \$1,600 (in parentheses) on line 15 of the passive category income Form 1116. Assuming you have no other line 15 adjustments, enter \$2,400 (\$4,000 – \$1,600) on line 16 of that form.

The amount of the loss that would reduce the certain income re-sourced by treaty would be 20% (\$1,000/\$5,000) of the \$2,000 loss or \$400. Include the \$400 in parentheses on line 15 of the certain income re-sourced by treaty Form 1116. Assuming you have no other line 15 adjustments, enter \$600 (\$1,000 – \$400) on line 16 of that form.

In this case, all of the \$2,000 loss was allocated between the foreign source passive category income and the certain income re-sourced by treaty category and no reduction was made to U.S. source income.

If you receive general category income in a later year, you must recharacterize all or part of that income as passive category income and certain income re-sourced by treaty in that later year. See the example under *Recharacterization of income* on this page.

**2. Recapture of prior year overall foreign loss.** If you had an overall foreign loss in a prior year that offset U.S. source income, a part of your foreign income (in the same category

as the loss) is treated as U.S. source income in each following tax year. The part that is treated as U.S. source income is the smallest of:

- The amount of overall foreign loss not recaptured in earlier years,
- 50% (or more, if you choose) of your taxable income from foreign sources, or
- The amount from line 14, less any adjustment for allocation of losses from other categories, as described under *Allocation of foreign losses* beginning on page 15.

Reduce the income on line 14 by including (in parentheses) on line 15 the smallest of a, b, or c above. This is the amount of the recapture. Be sure to attach your computation. If you elect to recapture more of an overall foreign loss than is required (b above), show in your computation the percentage of taxable income recaptured and the dollar amount of the recapture.

### **Dispositions of certain property.**

If you recognized foreign source gain in the same category as the overall foreign loss on a disposition of property that was used predominantly in a foreign trade or business and that generated foreign source income in the same category as the overall foreign loss, then the gain on the disposition may be subject to recapture as U.S. source income to the extent of 100% of your foreign source taxable income. See section 904(f)(3).

The above rule also generally applies to a gain on the disposition of stock in a controlled foreign corporation (CFC), if you owned more than 50 percent (by vote or value) of the stock right before you disposed of it. See section 904(f)(3)(D) for more information and exceptions.

Reduce line 14 by including (in parentheses) on line 15 the smallest of (a) the amount of the gain not recaptured under the two preceding paragraphs, (b) the remaining amount of the overall foreign loss not recaptured in earlier years or in the current year under the two preceding paragraphs, or (c) the amount from line 14, less any adjustment for allocation of losses from other categories and any adjustment under the two preceding paragraphs. See Pub. 514 if you disposed of property described above and you recognized foreign source gain in a different category than the overall foreign loss, you recognized U.S. source gain, or you did not recognize gain.

Attach a statement to Form 1116 showing the balance in each separate limitation overall foreign loss account. See Regulations section 1.904(f)-1(b) for more information.

### **3. Recharacterization of income.**

If, in a prior tax year, you reduced your foreign taxable income in the category checked above Part I by a pro rata share of a loss from another category, you must recharacterize in 2007 all or part of any income you receive in 2007 in that loss category. You recharacterize the income by:

- Increasing the amount on line 14 (adjusted by any of the other

adjustments previously mentioned in these line 15 instructions) of the Form 1116 for each of the separate categories, other than the loss category, previously reduced by including on line 15 any recharacterized income and

- Decreasing the amount on line 14 (adjusted by any of the other adjustments previously mentioned in these line 15 instructions) of the Form 1116 for the loss category by including on line 15 the amount of recharacterized income as a negative number (in parentheses).

**Example.** Using the facts in the example under *Allocation of foreign losses* on this page, in the next year (2008), you have \$5,000 of general category income, \$3,000 of passive category income, and \$500 of certain income re-sourced by treaty. Because \$1,600 of the general category income loss was used to reduce your passive category income in 2007, \$1,600 of your 2008 general category income must be recharacterized as passive category income. Similarly, \$400 of the general category income must be recharacterized as certain income re-sourced by treaty. On your 2008 Form 1116 for passive category income, you would include \$1,600 on line 15. On your 2008 Form 1116 for certain income re-sourced by treaty, you would include \$400 on line 15. On your 2008 Form 1116 for general category income, you would include (\$2,000) on line 15.



**Recharacterizing income from a separate category does not result in recharacterizing any tax.**

**4. Allocation of U.S. losses.** If you have a net loss from U.S. sources in 2008, proportionately allocate that loss among the separate categories of your foreign income. Reduce the income on line 14 (adjusted by any of the other adjustments previously mentioned in these line 15 instructions) by including (in parentheses) on line 15 the allocable portion of any U.S. loss. A U.S. loss includes a rental loss on property located in the United States. If you have any qualified dividends or capital gains (including capital gain distributions) or losses for the taxable year and you are required to make any adjustments to those amounts, as explained earlier under *Foreign Qualified Dividends and Capital Gains (Losses)* starting on page 5 or the instructions for line 17, the amount of your U.S. loss is the excess of:

- The total of the amounts entered on line 14 for each Form 1116 you are filing, over
- The amount entered on line 17 of the Form 1116.

### **Line 17**

If you have qualified dividends or capital gains, you may be required to make adjustments to those qualified dividends and gains before you take those amounts into account on line 17.

## Individuals Who Completed a Qualified Dividends and Capital Gain Tax Worksheet

If you completed the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for your tax return, you must use the Worksheet for Line 17 on this page to figure the amount to enter on line 17 if:

1. You file Form 1040 and
  - a. Line 7 of your Qualified Dividends and Capital Gain Tax Worksheet is greater than zero, and
  - b. Line 17 of your Qualified Dividends and Capital Gain Tax Worksheet is less than line 18 of that worksheet, OR
2. You file Form 1040NR and
  - a. Line 5 of your Qualified Dividends and Capital Gain Tax Worksheet is greater than zero, and
  - b. Line 15 of your Qualified Dividends and Capital Gain Tax Worksheet is less than line 16 of that worksheet.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust your qualified dividends and capital gains. You make this election by not completing the Worksheet for Line 17. If you make this election, you must elect not to adjust **any** of your qualified dividends or capital gains.

If you are not required to complete the Worksheet for Line 17 or you qualify for the adjustment exception and elect not to adjust your qualified dividends and capital gains, enter on line 17 of Form 1116 your taxable income without the deduction for your exemption (for example, the amount from Form 1040, line 41).

**Adjustment exception for Form 1040 filers.** You qualify for the adjustment exception if you meet both of the following requirements:

1. Line 7 of the Qualified Dividends and Capital Gain Tax Worksheet does not exceed:
  - \$195,850 if married filing jointly or qualifying widow(er);
  - \$97,925 if married filing separately;
  - \$160,850 if single; or
  - \$178,350 if head of household.
2. The amount of your foreign source net capital gain, plus the amount of your foreign source qualified dividends is less than \$20,000. For this purpose, ignore any capital gain distributions or qualified dividends you elected to include on Form 4952, line 4g.

**Adjustment exception for Form 1040NR filers.** You qualify for the adjustment exception if you meet both of the following requirements:

1. Line 5 of the Qualified Dividends and Capital Gain Tax Worksheet does not exceed:
  - a. \$195,850 if you checked filing status box 6,
  - b. \$97,925 if you checked filing status box 3, 4, or 5, or
  - c. \$160,850 if you checked filing status box 1 or 2.
2. The amount of your foreign source net capital gain, plus the amount of your foreign source qualified dividends is less than \$20,000.



*Your foreign source net capital gain is the excess of your foreign source net long-term capital gain over your foreign source net short-term capital loss.*

**Completing the Worksheet for Line 17.** If you do need to complete the Worksheet for Line 17, do the following.

**Lines 2 through 5.** Skip these lines.

- Line 6.** Enter the amount from:
- Line 14 of the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions, or
  - Line 12 of the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040NR instructions.

Complete all other lines as instructed on the worksheet.

## Estates and Trusts That Completed a Qualified Dividends Tax Worksheet or Schedule D

If you completed the Qualified Dividends Tax Worksheet in the instructions for Form 1041 or you completed Part V of Schedule D (Form 1041), you must use the Worksheet for Line 17 on this page to figure the amount to enter on line 17 if:

1. You figured your tax using the Qualified Dividends Tax Worksheet, line 5 of that worksheet is greater than zero, and line 15 of your Qualified Dividends Tax Worksheet is less than line 16 of that worksheet, or
2. You figured your tax using the Part V of Schedule D (Form 1041), line 23 of the Schedule D is greater than zero, and line 33 of the Schedule D is less than line 34.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust your qualified dividends and capital gains. You make this election by not completing the Worksheet for Line 17. If you make this election, you must elect not to adjust **any** of your qualified dividends or capital gains. You qualify for the adjustment exception if:

1. Line 5 of the Qualified Dividends Tax Worksheet or line 23 of Schedule D (Form 1041) does not exceed \$7,650, and
2. The amount of your foreign source net capital gain, plus the amount of your foreign source qualified dividends, is less than \$20,000. For this

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## Worksheet for Line 17 (Worldwide Qualified Dividends and Capital Gains)

*Keep for Your Records*

**Caution:** See the instructions for **Line 17** beginning on page 16 before starting this worksheet.

- |  |    |  |
|--|----|--|
| 1. <b>Individuals:</b> Enter the amount from Form 1040, line 41. If you are a nonresident alien, enter the amount from Form 1040NR, line 38. |    |  |
| <b>Estates and trusts:</b> Enter taxable income without the deduction for your exemption . . . . .   | 1. |  |
| 2. Enter your worldwide 28% gains (see instructions) . . . . .   | 2. |  |
| 3. Multiply line 2 by 0.2000 . . . . .   | 3. |  |
| 4. Enter your worldwide 25% gains (see instructions) . . . . .   | 4. |  |
| 5. Multiply line 4 by 0.2857 . . . . .   | 5. |  |
| 6. Enter your worldwide 15% gains and qualified dividends (see instructions) . . . . .   | 6. |  |
| 7. Multiply line 6 by 0.5714 . . . . .   | 7. |  |
| 8. Add lines 3, 5, and 7 . . . . .   | 8. |  |
| 9. Subtract line 8 from line 1. Enter the result here and on Form 1116, line 17 . . . . .  | 9. |  |

purpose, ignore any foreign source qualified dividends or capital gains that you elected to include on Form 4952, line 4g.



**TIP** Your foreign source net capital gain is the excess of your foreign source net long-term capital gain over your foreign source net short-term capital loss.

If you are not required to complete the Worksheet for Line 17 or you qualify for the adjustment exception and elect not to adjust your qualified dividends and capital gains, enter on line 17 of Form 1116 the estate's or trust's taxable income without the deduction for its exemption.

**Completing the Worksheet for Line 17.** If you do need to complete the Worksheet for Line 17, do the following.

**Lines 2 through 5.** Skip these lines.

**Line 6.** Enter the amount from line 12 of the Qualified Dividends Tax Worksheet or line 30 of Schedule D.

Complete all other lines as instructed on the worksheet.

## Taxpayers Who Completed the Schedule D Tax Worksheet

If you figured your tax using the Schedule D Tax Worksheet (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions), you must use the Worksheet for Line 17 on page 17 to figure the amount of tax to enter on line 17 of Form 1116 if:

- Line 17 of the Schedule D Tax Worksheet is greater than zero, and
- Line 35 of the Schedule D Tax Worksheet is less than line 36.

**Adjustment exception.** If you qualify for the adjustment exception, you can elect not to adjust your qualified dividends and capital gains. You make this election by not completing the Worksheet for Line 17. If you make this election, you must elect not to adjust any of your qualified dividends or capital gains. You qualify for the adjustment exception if:

1. The amount of your foreign source qualified dividends plus the amount of your foreign source net capital gain is less than \$20,000, and

2. Line 17 of the Schedule D Tax Worksheet (Form 1040) is less than or equal to:

- \$195,850 if married filing jointly or qualifying widow(er);
- \$97,925 if married filing separately;
- \$160,850 if single; or
- \$178,350 if head of household

(or, for trusts and estates, line 17 of the Schedule D Tax Worksheet (Form 1041) is less than or equal to \$7,650).



**TIP** Your foreign source net capital gain is the excess of your foreign source net long-term capital gain over your foreign source net short-term capital loss. Ignore any foreign source qualified dividends or capital gains that you elected to include

on Form 4952, line 4g, in determining the amount of your foreign source qualified dividends and net capital gain.

If you are not required to complete the Worksheet for Line 17 or you qualify for the adjustment exception and elect not to adjust your qualified dividends and capital gains, enter on line 17 of Form 1116 your taxable income without the deduction for your exemption (for example, the amount from Form 1040, line 41).

If you do need to complete the Worksheet for Line 17, do the following.

**Line 2.** Enter the amount (if any) from line 32 of the Schedule D Tax Worksheet.

**Line 4.** Enter the amount (if any) from line 29 of the Schedule D Tax Worksheet.

**Line 6.** Enter the amount (if any) from line 23 of the Schedule D Tax Worksheet.

Complete all other lines as instructed on the worksheet.

## Line 19

If you are completing line 19 for separate category e (lump-sum distributions), enter the amount from line 5 of the Worksheet for Lump-Sum Distributions on page 4.

Do not complete line 19 for separate category c (section 901(j) income). See page 3.

For all other applicable categories, complete line 19 as follows.

**Form 1040 filers.** Enter the amount from Form 1040, line 44, less any tax included on line 44 from Form 4972.

**Form 1040NR filers.** Enter the amount from Form 1040NR, line 41, less any tax included on line 41 from Form 4972.

**Form 1041 filers.** Enter the amount from Form 1041, Schedule G, line 1a.

## Line 21

The maximum foreign tax credit you can claim in the current year is generally limited to the allocated amount of U.S. tax imposed on the foreign income, or the actual amount of foreign tax paid or accrued on the foreign income (after reductions required on line 12), whichever is less. However, see *Foreign Taxes Eligible for a Credit* on page 2 for additional information.

If the amount on line 20 is smaller than the amount on line 13, see Pub. 514 for more information on carryback and carryforward provisions, including examples.

## Part IV—Summary of Credits From Separate Parts III

Complete lines 22 through 25 in Part IV only if you must complete more than one Form 1116 because you have

more than one of the categories of income listed above Part I.

Complete Part IV on only one Form 1116 (the one with the largest amount entered on line 21) to summarize the credits you figured on all of your Forms 1116. However, if you completed a Form 1116 for category e (lump-sum distributions) or c (section 901(j) income), do not use Part IV of that Form 1116 as your summary. Enter the credits from line 21 of all of your Forms 1116 on lines 22 through 25 of the Form 1116 with the largest amount entered on line 21 to summarize your credits. File the other Forms 1116 as attachments.

## Line 31

Enter the smaller of line 19 or line 26.

**Note.** Generally, line 26 will exceed line 19 only if you have U.S. capital gains or qualified dividends that are subject to the capital gain rate differential (figured in the Worksheet for Line 17 on page 17).

## 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 and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is: **Recordkeeping**, 2 hr., 43 min.; **Learning about the law or the form**, 1 hr., 5 min.; **Preparing the form**, 2 hr., 39 min.; **Copying, assembling, and sending the form to the IRS**, 34 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. You can write to the IRS at the address listed in the instructions of the tax return with which this form is filed.