corporation shall be computed in the same manner as if the foreign corporation were a domestic corporation.

(f) *Residence defined.* For purposes of paragraph (b)(1) of this section, the country of an individual's residence is to be determined by applying the rules under §§301.7701(b)–1 through 301.7701(b)–9 of this chapter.

(g) *Tax rate applicable to gain.* For purposes of paragraph (c) of this section, the tax rate applicable to the gain on the sale or exchange of personal property (as determined under chapter 1 of the Internal Revenue Code 1954) shall be determined by applying the tax laws of the foreign country or possession (and any applicable reduction under a tax treaty) to such gain and by treating the gain from such transaction as if such gain were the only income derived by the taxpayer during the taxable year (and the only deductions allowed are deductions directly attributable to such gain).

(h) *Country in which gross income derived.* Notwithstanding paragraph (d) of this section, for purposes of this section, dividends received by a shareholder who is not a U.S. person from a foreign corporation shall be deemed to be derived from sources within the foreign country under the laws of which the foreign corporation is created or organized.

[T.D. 7914, 48 FR 44524, Sept. 29, 1983, as amended by T.D. 8411, 57 FR 15241, Apr. 27, 1992]

§ 1.904(b)–4 Effective date.

Sections 1.904(b)–(1) and 1.904(b)–2 shall apply to taxable years beginning after December 31, 1975 and §1.904(b)–3 shall apply to sales and exchanges made after November 12, 1975.

[T.D. 7914, 48 FR 44525, Sept. 29, 1983]

§ 1.904(f)–1 Overall foreign loss and the overall foreign loss account.

(a) *Overview of regulations.* In general, section 904(f) and these regulations apply to any taxpayer that sustains an overall foreign loss (as defined in paragraph (c)(1) of this section) in a taxable year beginning after December 31, 1975. For taxable years ending after December 31, 1984, and beginning before January 1, 1987, there can be five types of overall foreign losses: a loss under each of the five separate limitations contained in former section 904(d)(1)(A) (passive interest limitation), (d)(1)(B) (DISC dividend limitation), (d)(1)(C) (foreign trade income limitation), (d)(1)(D) (foreign sales corporation (FSC) distributions limitation), and (d)(1)(E) (general limitation). For taxable years beginning after December 31, 1982, and ending before January 1, 1985, there can be three types of overall foreign losses under former section 904(d)(1)(A) (passive interest limitation), former section 904(d)(1)(B) (DISC dividend limitation) and former section 904(d)(1)(C) (general limitation). For taxpayers subject to section 907, the post-1982 general limitation overall foreign loss account may be further subdivided, as provided in §1.904(f)–6. For taxable years beginning after December 31, 1975, and before January 1, 1983, taxpayers should have computed overall foreign losses separately under the passive interest limitation, the DISC dividend limitation, the general limitation, and the section 907(b) (FORI) limitation. However, for taxable years beginning after December 31, 1975, and before January 1, 1983, taxpayers may have computed only two types of overall foreign losses: A foreign oil related loss under the FORI limitation and an overall foreign loss computed on a combined basis for the passive interest limitation, the DISC dividend limitation, and the general limitation. A taxpayer that computed overall foreign losses for these years on a combined basis will not be required to amend its return to recompute such losses on a separate basis. If a taxpayer computed its overall foreign losses for these years separately under the passive interest limitation, the DISC dividend limitation, and the general limitation, on returns previously filed, a taxpayer may not amend those returns to compute such overall foreign losses on a combined basis. Section 1.904(f)–1 provides rules for determining a taxpayer's overall foreign losses, for establishing overall foreign loss accounts, and for making additions to and reductions of such accounts for purposes of section 904(f). Section 1.904(f)–2 provides rules for recapturing the balance in any overall foreign loss account under the general recapture rule of section 904(f)(1) and under the special recapture rule of section 904(f)(3) when the taxpayer disposes of property used predominantly outside the United States in a trade or business. Section 1.904(f)–3 provides rules for allocating overall foreign losses that are part of net operating losses or net capital losses to foreign source income in years to which such losses are carried. In addition, § 1.904(f)–3 provides transition rules for the treatment of net operating losses incurred in taxable years beginning after December 31, 1982, and carried back to taxable years beginning before January 1, 1983, and of net operating losses incurred in taxable years beginning before January 1, 1983, and carried forward to taxable years beginning after December 31, 1982. Section 1.904(f)–4 provides rules for recapture out of an accumulation distribution of a foreign trust. Section 1.904(f)–5 provides rules for recapture of overall foreign losses of domestic trusts. Section 1.904(f)–6 provides a transition rule for recapturing a taxpayer's pre-1983 overall foreign losses under the general limitation and the FORI limitation out of taxable income subject to the general limitation in taxable years beginning after December 31, 1982. Section § 1.1502–9 provides rules concerning the application of these regulations to corporations filing consolidated returns.

(b) *Overall foreign loss accounts.* Any taxpayer that sustains an overall foreign loss under paragraph (c) of this section must establish an account for such loss. Separate types of overall foreign losses must be kept in separate accounts. For taxable years beginning prior to January 1, 1983, taxpayers that computed losses on a combined basis in accordance with § 1.904(f)–1(c)(1) will keep one overall foreign loss account for such overall foreign loss. The balance in each overall foreign loss account represents the amount of such overall foreign loss subject to recapture by the taxpayer in a given year. From year to year, amounts may be added to or subtracted from the balances in such accounts as provided in paragraphs (d) and (e) of this section. The taxpayer must report the balances (if any) in its overall foreign loss accounts annually on a Form 1116 or 1118. Such forms must be filed for each taxable year ending after September 24, 1987. The balance in each account does not have to be attributed to the year or years in which the loss was incurred.

(c) *Determination of a taxpayer's overall foreign loss*—(1) *Overall foreign loss defined.* For taxable years beginning after December 31, 1982, and before January 1, 1987, a taxpayer sustains an overall foreign loss in any taxable year in which its gross income from sources without the United States subject to a separate limitation (as defined in paragraph (c)(2) of this section) is exceeded by the sum of the deductions properly allocated and apportioned thereto. Such losses are to be determined separately in accordance with the principles of the separate limitations. Accordingly, income and deductions subject to a separate limitation are not to be netted with income and deductions subject to another separate limitation for purposes of determining the amount of an overall foreign loss. A taxpayer may, for example, have an overall foreign loss under the general limitation in the same taxable year in which it has taxable income under the DISC dividend limitation. The same principles of calculating overall foreign losses on a separate limitation basis apply for taxable years beginning before January 1, 1983, except that a taxpayer shall determine its overall foreign losses on a combined basis, except for income subject to the FORI limitation, if the taxpayer filed its pre-1983 returns on such basis. Thus, for taxable years beginning prior to January 1, 1983, a taxpayer can net income and losses among the passive interest limitation, the DISC dividend limitation, and the general limitation if the taxpayer calculated its overall foreign losses that way at the time. Taxpayers that computed overall foreign losses separately under each of the separate limitations on their returns filed for taxable years beginning prior to January 1, 1983, may not amend such returns to compute their overall foreign losses for pre-1983 years on a combined basis.

(2) *Separate limitation defined.* For purposes of paragraph (c)(1) of this section and these regulations, the term separate limitation means any of the

separate limitations under former section 904(d)(1)(A) (passive interest limitation), (B) (DISC dividend limitation), (C) (foreign trade income limitation), (D) (FSC distributions limitation), and (E) (general limitation) and the separate limitation under section 907(b) (FORI limitation) (for taxable years ending after December 31, 1975, and beginning before January 1, 1983).

(3) *Method of allocation and apportionment of deductions.* In determining its overall foreign loss, a taxpayer shall allocate and apportion expenses, losses, and other deductions to the appropriate category of gross income in accordance with section 862(b) and §1.861–8 of the regulations. However, the following deductions shall not be taken into account:

(i) The amount of any net operating loss deduction for such year under section 172(a); and

(ii) To the extent such losses are not compensated for by insurance or otherwise, the amount of any—

(A) Expropriation losses for such year (as defined in section 172(h)), or

(B) Losses for such year which arise from fire, storm, shipwreck, or other casualty, or from theft.

(d) *Additions to the overall foreign loss account*—(1) *General rule.* A taxpayer's overall foreign loss as determined under paragraph (c) of this section shall be added to the applicable overall foreign loss account at the end of its taxable year to the extent that the overall foreign loss has reduced United States source income during the taxable year or during a year to which the loss has been carried back. For rules with respect to carryovers see paragraph (d)(4) of this section and §1.904(f)–3.

(2) *Overall foreign net capital loss.* An overall foreign net capital loss shall be added to the applicable overall foreign loss account at the end of the taxable year to the extent that the foreign source capital loss has reduced United States source capital gain net income during the taxable year or during a year to which the loss has been carried back, subject to the adjustments in paragraph (d)(5) of this section. For rules with respect to carryovers, see paragraph (d)(4) of this section and §1.904(f)–3. As provided under section 1211(b), to the extent that a foreign source net capital loss has reduced United States source income other than United States source capital gain net income, this additional amount would be added to the taxpayer's overall foreign loss account as if the United States source income had been offset by a foreign net operating loss that is not a capital loss.

(3) *Overall foreign losses of another taxpayer.* If any portion of any overall foreign loss of another taxpayer is allocated to the taxpayer in accordance with §1.904(f)–5 (relating to overall foreign losses of domestic trusts) or §1.1502–9 (relating to consolidated overall foreign losses), the taxpayer shall add such amount to its applicable overall foreign loss account.

(4) *Additions to overall foreign loss account created by loss carryovers.* Subject to the adjustments under §1.904(f)–1(d)(5), the taxpayer shall add to each overall foreign loss account—

(i) All net operating loss carryovers to the current taxable year attributable to the same limitation to the extent that overall foreign losses included in the net operating loss carryovers reduced United States source income for the taxable year, and

(ii) All capital loss carryovers to the current taxable year attributable to the same limitation to the extent that foreign source capital loss carryovers reduced United States source capital gain net income for the taxable year.

(5) *Adjustments.* The amount of overall foreign loss determined in paragraph (d)(1) of this section and the amount of overall foreign net capital loss determined in paragraph (d)(2) of this section which shall be added to a taxpayer's overall foreign loss account shall be adjusted as follows prior to being added to an account.

(i) *Adjustment due to reduction in foreign source income under section 904(b).* A taxpayer's overall foreign loss account shall not include any net capital loss from sources without the United States to the extent that the application of section 904(b) would result in a reduction of foreign source taxable income (but not below zero) for purposes of the numerator of the foreign tax credit limitation fraction.

(ii) *Adjustment to account for rate differential between ordinary income rate and capital gain rate.* Subject to the provisions of paragraph (d)(5)(i) of this section, if an overall foreign loss for a taxable year includes an overall foreign net capital loss, such amount shall be reduced as follows, in accordance with the provisions of section 904(b), before being added to the overall foreign loss account:

(A) In the case of a corporate taxpayer, to the extent that the United States source capital gain net income reduced by the foreign source net capital loss consists of United States source net capital gain, by an amount equal to the rate differential portion (as defined in section 904(b)(3)(D) of the Code and the regulations thereunder) of the United States source net capital gain; or

(B) In the case of a taxpayer other than a corporate taxpayer, for taxable years beginning prior to January 1, 1979, an amount equal to the taxpayer's United States source net capital gain that is offset by such foreign source net capital loss reduced by 50 percent of such gain, and for taxable years beginning after December 31, 1978, and before January 1, 1987, reduced by an amount equal to 60 percent of such gain.

(e) *Reductions of overall foreign loss accounts.* The taxpayer shall subtract the following amounts from its overall foreign loss accounts at the end of its taxable year in the following order, if applicable:

(1) *Pre-recapture reduction for amounts allocated to other taxpayers.* An overall foreign loss account is reduced by the amount of any overall foreign loss which is allocated to another taxpayer in accordance with §1.904(f)–5 (relating to overall foreign losses of domestic trusts) or §1.1502–9 (relating to consolidated overall foreign losses).

(2) *Reduction for amounts recaptured.* An overall foreign loss account is reduced by the amount of any foreign source income that is subject to the same limitation as the loss that resulted in the account and that is recaptured in accordance with §1.904(f)–2 (c) (relating to recapture under section 904(f)(1)); §1.904(f)–2 (d) (relating to recapture when the taxpayer disposes of certain properties under section 904(f)(3)); and §1.904(f)–4 (relating to recapture when the taxpayer receives an accumulation distribution from a foreign trust under section 904(f)(4)).

(f) *Illustrations.* The rules of this section are illustrated by the following examples.

Example 1. X Corporation is a domestic corporation with foreign branch operations in country C. X's taxable income and losses for its taxable year 1983 are as follows:

U.S. Source taxable income	$1,000
Foreign source taxable income (loss) subject to the general limitation	($500)
Foreign source taxable income subject to the passive interest limitation	$200

X has a general limitation overall foreign loss of $500 for 1983 in accordance with paragraph (c) (1) of this section. Since the general limitation overall foreign loss is not considered to offset income under the separate limitation for passive interest income, it therefore offsets $500 of United States source taxable income. This amount is added to X's general limitation overall foreign loss account at the end of 1983 in accordance with paragraphs (c) (1) and (d) (1) of this section.

Example 2. Y Corporation is a domestic corporation with foreign branch operations in Country C. Y's taxable income and losses for its taxable year 1982 are as follows:

U.S. source taxable income	$1,000
Foreign source taxable income (loss) subject to the general limitation	($500)
Foreign source taxable income subject to the passive interest limitation	$250

For its pre-1983 taxable years, Y filed its returns determining its overall foreign losses on a combined basis. In accordance with paragraphs (a) and (c) (1) of this section, Y may net the foreign source income and loss before offsetting the United States source income. Y therefore has a section 904(d)(1)(A–C) overall foreign loss account of $250 at the end of 1982.

Example 3. X Corporation is a domestic corporation with foreign branch operations in country C. For its taxable year 1985, X has taxable income (loss) determined as follows:

U.S. source taxable income	$200
Foreign source taxable income (loss) subject to the general limitation	($1,000)
Foreign source taxable income (loss) subject to the passive limitation	$1,800

X has a general limitation overall foreign loss of $1,000 in accordance with paragraph (c)(1) of this section. The overall foreign loss offsets $200 of United States source taxable income in 1985 and, therefore, X has a $200 general limitation overall foreign loss account at the end of 1985. The remaining $800 general limitation loss is offset by the passive interest limitation income in 1985 so that X has no net operating loss carryover that is attributable to the general limitation loss and no additional amount attributable to that loss will be added to the overall foreign loss account in 1985 or in any other year.

Example 4. In 1986, V Corporation has $1000 of general limitation foreign source taxable income and $500 of general limitation foreign source net capital loss which has reduced $500 of United States source capital gain net income (''short term gain'') (none of which is net capital gain). Under section 904(b), the numerator of V's foreign tax credit limitation fraction for income subject to the general limitation is reduced by $500 (see §1.904 (b)–1 (a)(3)). Under paragraph (d)(5)(i) of this section, none of that $500 goes into its general limitation overall foreign loss account.

Example 5. Z Corporation is a domestic corporation with foreign branch operations. For the taxable year 1984, Z's taxable income and (losses) are as follows:

U.S. source taxable ordinary income	$1,000
U.S. source net capital gain	$460
Foreign source taxable ordinary income subject to the general limitation	$200
Foreign source net capital loss subject to the general limitation	($800)

Z had no capital gain net income in any prior taxable year. Under paragraph (d)(2) and (5) of this section, the amount to be added to Z's general limitation overall foreign loss account is the excess of the amount which has reduced United States source capital gain net income for the taxable year ($460), adjusted for the rate differential because it has reduced United States source net capital gain ($460 × 28/46 = $280), over the amount which has reduced the numerator of Z's foreign tax credit limitation fraction under section 904(b)(2), which is $200. (The $200 amount is foreign source net capital loss that has reduced United States source net capital gain in the denominator of the fraction, but not exceeding the amount of foreign source income in the numerator before the section 904(b)(2) adjustment.) Thus, Z must add $80 (the excess of the $280 over $200) to its general limitation overall foreign loss account in 1984.

[T.D. 8153, 52 FR 31994, Aug. 25, 1987; 52 FR 43434, Nov. 12, 1987]

§ 1.904(f)–2 Recapture of overall foreign losses.

(a) *In general.* A taxpayer shall be required to recapture an overall foreign loss as provided in this section. Recapture is accomplished by treating as United States source income a portion of the taxpayer's foreign source taxable income of the same limitation as the foreign source loss that resulted in an overall foreign loss account. As a result, if the taxpayer elects the benefits of section 901 or section 936, the taxpayer's foreign tax credit limitation with respect to such income is decreased. As provided in §1.904 (f)–1(e)(2), the balance in a taxpayer's overall foreign loss account is reduced by the amount of loss recaptured. Recapture continues until such time as the amount of foreign source taxable income recharacterized as United States source income equals the amount in the overall foreign loss account. As provided in §1.904 (f)–1(e)(2), the balance in a overall foreign loss account is reduced at the end of each taxable year by the amount of the loss recaptured during that taxable year. Regardless of whether recapture occurs in a year in which a taxpayer elects the benefits of section 901 or in a year in which a taxpayer deducts its foreign taxes under section 164, the overall foreign loss account is recaptured only to the extent of foreign source taxable income remaining after applying the appropriate section 904(b) adjustments, if any, as provided in paragraph (b) of this section.

(b) *Determination of taxable income from sources without the United States for purposes of recapture*—(1) *In general.* For purposes of determining the amount of an overall foreign loss subject to recapture, the taxpayer's taxable income from sources without the United States shall be computed with respect to each of the separate limitations described in §1.904 (f)–1(c)(2) in accordance with the rules set forth in §1.904 (f)–1(c) (1) and (3). This computation is made without taking into account foreign source taxable income (and deductions properly allocated and apportioned thereto) subject to other separate limitations. Before applying the recapture rules to foreign source