

abroad. For taxable years prior to 1983, Z computed its overall foreign losses on a separate limitation basis. In 1980, Z had \$100 of United States source income and (\$100) of foreign source loss subject to the general limitation. On December 31, 1980, the balance in Z's general limitation overall foreign loss account was \$100. In 1981, Z had \$50 of United States source income and \$100 of general limitation foreign source income. In 1982, Z also had \$50 United States source income and \$100 foreign source general limitation income. Therefore, in both 1981 and 1982, Z recaptured \$50 and at the end of 1982, Z's general limitation overall foreign loss account was reduced to zero. In 1983, Z had no income. In 1984, Z had a (\$150) United States source loss and a (\$150) general limitation foreign source loss. The 1984 net operating loss is carried back first to 1981 and then to 1982. Because of the overall foreign loss recapture that occurred in those years, Z is considered to have \$100 of United States source income and \$50 of foreign source income in each year. Thus, in 1981, (\$50) of the (\$150) foreign source component of the carryback eliminated the \$50 foreign source income in that year and (\$100) of the (\$150) domestic source component of the carryback eliminated the United States source income in that year. In 1982, (\$50) of the remaining domestic source component of the net operating loss reduced the United States source income to \$50. The remaining (\$100) of the foreign source component of the loss first reduced the foreign source income to zero and then reduced the remaining United States source income to zero, thus creating a \$50 overall foreign loss. Therefore, at the end of 1984, Z has \$50 in its general limitation overall foreign loss account.

Example 4. In 1985, V Corporation has a general limitation loss of <\$1,000> and no other income or loss in that year. The 1985 loss is carried back to 1982. For taxable years prior to 1983, V computed its overall foreign losses on a combined basis for income subject to the passive interest limitation, the DISC dividend limitation, and the general limitation. In 1982, V had \$400 of passive interest limitation income and \$200 of general limitation income and \$1,000 of United States source taxable income. Under paragraph (d) of this section, the \$1,000 NOL attributable to the 1985 loss is first offset by the general limitation income in 1982 and then the United States source passive interest limitation income in that year. V therefore adds \$800 to its general limitation overall foreign loss account in 1985.

Example 5. In 1982, W Corporation has a general limitation loss of <\$500> and \$200 of passive interest limitation income. For taxable years prior to 1983, W computed its overall foreign losses on a combined basis. W has no other taxable income or loss. W cannot carry back the \$300 NOL and so it carries it forward to 1983, a year in which it has \$600

passive interest limitation income and \$500 of United States source income and no general limitation income. Under paragraph (d) of this section, the NOL is not offset by the foreign source income in 1984 but first is applied against United States source income. Thus, \$300 is added to W's general limitation overall foreign loss account in 1984.

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§ 1.904(f)-4 Recapture of foreign losses out of accumulation distributions from a foreign trust.

(a) *In general.* If a taxpayer receives a distribution of foreign source taxable income subject to a separate limitation in which the taxpayer had a balance in an overall foreign loss account and that income is treated under section 666 as having been distributed by a foreign trust in a preceding taxable year, a portion of the balance in the taxpayer's applicable overall foreign loss account shall be subject to recapture under this section. The amount subject to recapture shall be the lesser of the balance in the taxpayer's overall foreign loss account (after applying §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, and 1.904(f)-6 to the taxpayer's other income or loss in the current taxable year) or the entire amount of foreign source taxable income deemed distributed in a preceding year or years under section 666.

(b) *Effect of recapture on foreign tax credit limitation under section 667(d).* If paragraph (a) of this section is applicable, then in applying the separate limitation (in accordance with section 667(d)(1) (A) and (C)) to determine the amount of foreign taxes deemed distributed under section 666 (b) and (c) that can be credited against the increase in tax in a computation year, a portion of the foreign source taxable income deemed distributed in such computation year shall be treated as United States source income. Such portion shall be determined by multiplying the amount of foreign source taxable income deemed distributed in the computation year by a fraction. The numerator of this fraction is the balance in the taxpayer's overall foreign loss account (after application of §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, and

1.904(f)-6), and the denominator of the fraction is the entire amount of foreign source taxable income deemed distributed under section 666. However, the numerator of this fraction shall not exceed the denominator of the fraction.

(c) *Recapture if taxpayer deducts foreign taxes deemed distributed.* If paragraph (a) of this section is applicable and if, in accordance with section 667(d)(1)(B), the beneficiary deducted rather than credited its taxes in the computation year, the beneficiary shall reduce its overall foreign loss account (but not below zero) by an amount equal to the lesser of the balance in the applicable overall foreign loss account or the amount of the actual distribution deemed distributed in the computation year (without regard to the foreign taxes deemed distributed).

(d) *Illustrations.* The provisions of this section are illustrated by the following examples:

Example 1. X Corporation is a domestic corporation that has a balance of \$10,000 in its general limitation overall foreign loss account on December 31, 1980. For its taxable year beginning January 1, 1981, X's only income is an accumulation distribution from a foreign trust of \$20,000 of general limitation foreign source taxable income. Under section 666, the amount distributed and the foreign taxes paid on such amount (\$4,000) are deemed distributed in two prior taxable years. In determining the partial tax on such distribution under section 667(b), the amount added to each computation year is \$12,000 (the sum of the actual distribution plus the taxes deemed distributed (\$24,000) divided by the number of accumulation years (2)). Of that amount, \$5,000 ($\$10,000/\$24,000 \times \$12,000$) is treated as United States source taxable income in accordance with paragraph (b) of this section. Assuming the United States tax rate is 50 percent, X's separate foreign tax credit limitation against the increase in tax in each computation year is \$3,500 ($\$7,000/\$12,000 \times \$6,000$) instead of \$6,000 ($\$12,000/\$12,000 \times \$6,000$). X's overall foreign loss account is reduced to zero in accordance with paragraph (a) of this section.

Example 2. Assume the same facts as in Example 1, except that X deducted rather than credited its foreign taxes in the computation years. In 1979, the amount added to X's income is \$12,000 under section 667(b), \$2,000 of which is deductible under section 667(d)(1)(B). X must reduce its overall foreign loss account by \$10,000, the amount of the actual distribution that is deemed distributed in 1979 (without regard to the \$2,000 foreign

taxes also deemed distributed). The entire overall foreign loss account is therefore reduced to \$0 in 1979.

[T.D. 8153, 52 FR 32002, Aug. 25, 1987]

§ 1.904(f)-5 Special rules for recapture of overall foreign losses of a domestic trust.

(a) *In general.* Except as provided in this section, the rules contained in §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, 1.904(f)-4, and 1.904(f)-6 apply to domestic trusts.

(b) *Recapture of trust's overall foreign loss.* In taxable years in which a trust has foreign source taxable income subject to a separate limitation in which the trust has a balance in its overall foreign loss account, the balance in the trust's overall foreign loss account shall be recaptured as follows:

(1) *Trust accumulates income.* If the trust accumulates all of its foreign source taxable income subject to the same limitation as the loss that created the balance in the overall foreign loss account, its overall foreign loss shall be recaptured out of such income in accordance with §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, 1.904(f)-4, and 1.904(f)-6.

(2) *Trust distributes income.* If the trust distributes all of its foreign source taxable income subject to the same limitation as the loss that created the overall foreign loss account, the amount of the overall foreign loss that would be subject to recapture by the trust under paragraph (b)(1) of this section shall be allocated to the beneficiaries in proportion to the amount of such income which is distributed to each beneficiary in that year.

(3) *Trust accumulates and distributes income.* If the trust accumulates part of its foreign source taxable income subject to the same limitation as the loss that created the overall foreign loss account and distributes part of such income, the portion of the overall foreign loss that would be subject to recapture by the trust under paragraph (b)(1) of this section if the distributed income were accumulated shall be allocated to the beneficiaries receiving income distributions. The amount of overall foreign loss to be allocated to such beneficiaries shall be the same portion of the total amount of such overall foreign loss that would be recaptured as