

## § 1.907(a)-1

## 26 CFR Ch. I (4-1-02 Edition)

the lesser of the separate excess extraction limitation or the excess limitation in the general limitation category (section 904(d)(1)(I)) for the carryback or carryover year. See § 1.907(f)-1.

(i) *Statutes covered.* The regulations under section 907 are issued as a result of the enactment of section 601 of the Tax Reduction Act of 1975, of section 1035 of the Tax Reform Act of 1976, of section 301(b)(14) of the Revenue Act of 1978, of section 211 of the Tax Equity and Fiscal Responsibility Act of 1982 and of section 1012(g)(6) (A)-(B) of the Technical and Miscellaneous Revenue Act of 1988.

[T.D. 8338, 56 FR 11065, Mar. 15, 1991]

### § 1.907(a)-1 Reduction in taxes paid on FOGEI (for taxable years beginning after December 31, 1982).

(a) *Amount of reduction.* FOGEI taxes are reduced by the amount by which they exceed a limitation level (as defined in paragraph (c) of this section).

(b) *Foreign taxes paid or accrued.* For purposes of the regulations under section 907—

(1) *Foreign taxes.* The term “foreign taxes” means income, war profits, or excess profits taxes of foreign countries or possessions of the United States otherwise creditable under section 901 (including those creditable by reason of section 903).

(2) *Foreign taxes paid or accrued.* The terms “foreign taxes paid or accrued,” “FOGEI taxes paid or accrued,” and “FORI taxes paid or accrued” include foreign taxes deemed paid under sections 902 and 960. Unless otherwise expressly provided, these terms do not include foreign taxes deemed paid by reason of sections 904(c) and 907(f).

(c) *Limitation level—(1) In general.* The limitation level is FOGEI for the taxable year multiplied by the limitation percentage for that year.

(2) *Limitation percentage for corporations.* A corporation’s limitation percentage is the highest rate of tax specified in section 11(b) for the particular year.

(3) *Limitation percentage for individuals.* Section 907(a)(2)(B) provides that the limitation percentage for individual taxpayers is the effective rate of tax for those taxpayers. The effective rate of tax is computed by dividing the

entire tax, before the credit under section 901(a) is taken, by the taxpayer’s entire taxable income.

(4) *Losses.* (i) For purposes of determining whether income is FOGEI, a taxpayer’s FOGEI will be recharacterized as foreign source non-FOGEI to the extent that FOGEI losses for preceding taxable years beginning after December 31, 1982, exceed the amount of FOGEI already recharacterized. See § 1.907(c)-1(c). However, taxes that were paid or accrued on the recharacterized FOGEI will remain FOGEI taxes.

(ii) Taxes paid or accrued by a person to a foreign country may be FOGEI taxes even though that person has under U.S. law a net operating loss from sources within that country.

(iii) For purposes of determining whether income is FOGEI, a taxpayer’s income will be treated as income from sources outside the United States even though all or a portion of that income may be resourced as income from sources within the United States under section 904(f) (1) and (4).

(5) *Priority.* (i) Section 907(a) applies before section 908, relating to reduction of credit for participation in or cooperation with an international boycott.

(ii) Section 901(f) (relating to certain payments with respect to oil and gas not considered as taxes) applies before section 907.

(d) *Illustrations.* Paragraphs (a) through (c) of this section are illustrated by the following examples.

*Example 1.* M, a U.S. corporation, uses the accrual method of accounting and the calendar year as its taxable year. For 1984, M has \$20,000 of FOGEI, derived from operations in foreign countries X and Y, and has accrued \$11,500 of foreign taxes with respect to FOGEI. The highest tax rate specified in section 11(b) for M’s 1984 taxable year is 46 percent. Pursuant to section 907(a), M’s FOGEI taxes limitation level for 1984 is \$9,200 (46% $\times$ \$20,000). The foreign taxes in excess of this limitation level (\$2,300) may be carried back or forward. See section 907(f) and § 1.907(f)-1 and section 907(e) and § 1.907(e)-1.

*Example 2.* The facts are the same as in *Example 1* except that M is a partnership owned equally by U.S. citizens A and B who each file as unmarried individuals and do not itemize deductions. Pursuant to section 905(a), A and B have elected to credit foreign taxes in the year accrued. The total amount

of foreign taxes accrued by A and B with respect to their distributive shares of M's FOGEI is \$11,500 (\$5,750 accrued by A and \$5,750 accrued by B). A and B have no other FOGEI. A's only taxable income for 1984 is his 50% distributive share (\$10,000) of M's FOGEI and A has a preliminary U.S. tax liability of \$1,079. B has \$112,130 of taxable income for 1984 (including his 50% distributive share (\$10,000) of M's FOGEI) and has a preliminary U.S. tax liability of \$44,000. Pursuant to section 907(a), A's FOGEI taxes limitation level for 1984 is \$1,079  $((\$1,079/\$10,000) \times \$10,000)$  and B's FOGEI taxes limitation level for 1984 is \$3,924  $((\$44,000/\$112,130) \times \$10,000)$ .

(e) *Effect on other provisions*—(1) *Deduction denied.* If a credit is claimed under section 901, no deduction under section 164(a)(3) is allowed for the amount of the FOGEI taxes that exceed a taxpayer's limitation level for the taxable year. See section 275(a)(4)(A). Thus, FOGEI taxes disallowed under section 907(a) are not added to the cost or inventory amount of oil or gas.

(2) *Reduction inapplicable.* The reduction under section 907(a) does not apply to a taxpayer that deducts foreign taxes and does not claim the benefits of section 901 for a taxable year.

(3) *Section 78 dividend.* The reduction under section 907(a) has no effect on the amount of foreign taxes that are treated as dividends under section 78.

(f) *Section 904 limitation.* FOGEI taxes as reduced under section 907(a) are creditable only to the extent permitted by the general limitation of section 904(d)(1)(I).

[T.D. 8338, 56 FR 11066, Mar. 15, 1991]

**§ 1.907(b)-1 Reduction of creditable FORI taxes (for taxable years beginning after December 31, 1982).**

If the foreign law imposing a FORI tax (as defined in § 1.907(c)-3) is either structured in a manner, or operates in a manner, so that the amount of tax imposed on FORI is generally materially greater than the tax imposed by the foreign law on income that is neither FORI nor FOGEI ("described manner"), section 907(b) provides a special rule which limits the amount of FORI taxes paid or accrued by a person to a foreign country which will be considered income, war profits, or excess profits taxes. Section 907(b) will apply to a person regardless of whether that

person is a dual capacity taxpayer as defined in § 1.901-2(a)(2)(ii)(A). (In general, a dual capacity taxpayer is a person who pays an amount to a foreign country part of which is attributable to an income tax and the remainder of which is a payment for a specific economic benefit derived from that country.) Foreign law imposing a tax on FORI will be considered either to be structured in or to operate in the described manner only if, under the facts and circumstances, there has been a shifting of tax by the foreign country from a tax on FOGEI to a tax on FORI.

[T.D. 8338, 56 FR 11066, Mar. 15, 1991]

**§ 1.907(c)-1 Definitions relating to FOGEI and FORI (for taxable years beginning after December 31, 1982).**

(a) *Scope.* This section explains the meaning to be given certain terms and items in section 907(c) (1), (2), and (4). See also §§ 1.907(a)-0(b) and 1.907(c)-2 for further definitions.

(b) *FOGEI*—(1) *General rule.* Under section 907(c)(1), FOGEI means taxable income (or loss) derived from sources outside the United States and its possessions from the extraction (by the taxpayer or any other person) of minerals from oil or gas wells located outside the United States and its possessions or from the sale or exchange of assets used by the taxpayer in the trade or business of extracting those minerals. Extraction of minerals from oil or gas wells will result in gross income from extraction in every case in which that person has an economic interest in the minerals in place. For other circumstances in which gross income from extraction may arise, see paragraph (b)(3) of this section. For determination of the amount of gross income from extraction, see paragraph (b)(2) of this section. For definition of the phrase "assets used by the taxpayer in the trade or business" and for rules relating to that type of FOGEI, see paragraph (e)(1) of this section. The term "minerals" is defined in paragraph (f)(1) of this section. For determination of taxable income, see paragraph (f)(2) of this section. FOGEI includes, in addition, items listed in section 907(c)(3) (relating to dividends, interest, partnership distributions, etc.)