



Instructions for Form 1118

Computation of Foreign Tax Credit—Corporations

(Revised February 1973)

(References are to the Internal Revenue Code.)

A. Corporations required to file Form 1118.

Form 1118 must be attached to the income tax return of any corporation claiming a credit for (1) income, war profits, or excess profits tax paid or accrued during a taxable year to any foreign country or U.S. possession and (2) the taxes deemed to have been paid under sections 902 and 960.

The term "income, war profits, and excess profits tax" includes a tax imposed by statute or decree by a foreign country or U.S. possession if (1) the country or possession has in force a general income tax law, (2) the corporation claiming the credit would, in the absence of a specific provision applicable to the corporation, be subject to the general income tax, and (3) the general income tax is not imposed on the corporation subject to such substituted tax. (Section 1.903-1(a) of the regulations.)

B. Corporations not allowed credit.

The credit is not allowed to (1) a China Trade Act corporation (section 942); (2) a domestic corporation entitled to the benefits of section 931 for income from U.S. possessions (section 931(g)); (3) a regulated investment company which has exercised the election under section 853; or (4) a DISC as defined in section 992(a). (Section 1.901-1 of the regulations.)

C. Taxes against which credit is not allowed.

The foreign tax credit is allowed against income tax imposed by chapter 1 but not against any: (1) minimum tax for tax preferences imposed by section 56; (2) tax on accumulated earnings imposed by section 531; (3) personal

holding company tax imposed by section 541; (4) additional tax imposed by section 1333 (relating to war loss recoveries) and under section 1351 (relating to recoveries of foreign expropriation losses); (5) increase in tax under section 47 (relating to dispositions of investment credit property); or (6) increase in tax under section 50A(c) (relating to early termination of employment by an employer in a WIN program).

Foreign corporations may not take the credit against any tax imposed by section 881 on income not effectively connected with the conduct of a trade or business within the U.S.

D. No deduction if a credit is claimed.

If a corporation elects for any taxable year to claim a credit for taxes to any extent, the election will apply to income, war profits, and excess profits tax paid or accrued in the taxable year to all foreign countries and U.S. possessions and no portion of the tax will be allowed as a deduction in the taxable year or any succeeding taxable year. (Section 1.901-1(c) of the regulations and section 275(a)(4).)

The election for any taxable year may be made or changed at any time before the end of the period prescribed for making a claim for credit or refund of tax for the taxable year. (Section 901.)

Members of an affiliated group electing under section 243 to deduct 100% of qualifying dividends received from members of the same affiliated group are treated as one taxpayer for purposes of making elections under sections 901(a) and 904(b)(1).

E. Method of reporting.

Report all amounts in U.S. dollars except in column 6(a) of Schedule A. If it is necessary to convert from

foreign currency, attach a statement explaining why and how you determined the rate.

F. Taxes of foreign corporation.

(1) **Domestic corporation owning stock of a foreign corporation.**—If a domestic corporation owns 10% or more of the voting stock of a related foreign corporation (first foreign corporation) from which it receives dividends, a proportionate amount of the taxes paid or accrued by the first foreign corporation are deemed to have been paid by the domestic corporation for purposes of the foreign tax credit. (Section 902(a).)

For computation of taxes deemed paid by a domestic corporation with respect to a related foreign corporation, related domestic corporation, or DISC or former DISC; see Schedule B.

(2) **First foreign corporation owning stock of a second foreign corporation.**—If the first foreign corporation in (1) above owns 10% or more of the voting stock of a second foreign corporation from which it receives dividends, the first foreign corporation will be deemed to have paid a proportionate amount of the foreign taxes of the second foreign corporation. (Section 902(b)(1).)

However, for purposes of the foreign tax credit, section 902(b)(1) will not apply unless the percentage of voting stock owned by the domestic corporation in the first foreign corporation and the percentage of voting stock owned by the first foreign corporation in the second foreign corporation equal at least 5% when multiplied together.

Section 902(b)(1) applies to taxable years of domestic corporations ending after January 12, 1971, but only to dividends paid by one corporation to another corporation after January 12, 1971.

For computation of taxes deemed paid by the first foreign corporation with respect to a second foreign corporation, see Schedule C.

(3) **Second foreign corporation owning stock of a third foreign corporation.**—If the first foreign corporation owns 10% or more of the voting stock of a second foreign corporation which, in turn, owns 10% or more of the voting stock of a third foreign corporation from which the second foreign corporation receives dividends, the second foreign corporation will be deemed to have paid a proportionate amount

of the foreign taxes of the foreign corporation. (Section 902(b)(2).)

However, section 902(b)(2) will not apply unless the percentage computed in applying section 902(b)(1) when multiplied by the percentage of voting stock owned by the second foreign corporation in the third foreign corporation equals at least 5%. Section 902(b)(2) applies to taxable years of domestic corporations ending after January 12, 1971, but only to dividends paid by one corporation to another corporation after January 12, 1971.

For computation of taxes deemed paid by a second foreign corporation with respect to a third foreign corporation, see Schedule D.

(4) Country to which tax is deemed paid.—For purposes of section 904 (limitation on foreign tax credit), all foreign income tax paid, or deemed paid, by a foreign corporation is deemed to be paid to the foreign country or U.S. possession under the laws of which the foreign corporation is created or organized. (Section 1.902-3(d)(2) of the regulations.)

(5) Corporation treated as foreign.—The term “foreign corporation” as used above includes a domestic corporation entitled to the benefits of section 931 or 941. (Section 901(d).)

Dividends from a DISC or former DISC (as defined in section 992(a)) are treated as dividends from a foreign corporation to the extent the dividends are treated under sections 861 through 864 as income from sources without the U.S.

(6) Controlled foreign corporations.—As provided in the heading instructions in Schedule B, attach a schedule showing the computation of the foreign tax credit under section 960. The schedule should be in a format similar to Schedule B. (Note: Present section 960 and the regulations thereunder do not provide for a deemed paid credit for a third-tier corporation.)

G. Limitation on credit.

The credit is limited to a percentage of total U.S. income tax. The computation must be made by using either the per-country limitation or the overall limitation.

(1) Per-country limitation.—If the overall limitation is not elected, the per-country limitation applies.

Under the per-country limitation, the credit is computed separately for each foreign country or U.S. possession. The credit is limited to that percentage of total U.S. income tax which taxable income from sources within each country or U.S. possession (but not in excess of total taxable income) is of total taxable income. (Section 904(a)(1).)

(2) Overall limitation.—If the overall limitation is elected, the credit is computed on the total amount of tax paid to all foreign countries and U.S. possessions. The credit is limited to that percentage of total U.S. income tax which taxable income from all sources without the U.S. (but not in excess of total taxable income) is of total taxable income. (Section 904(a)(2).)

(3) Election of overall limitation.—The per-country limitation is to apply unless you elect to use the overall limitation. You can make the initial election to use the overall limitation by checking the appropriate box at the top of Schedule A. You can make the initial election without the Commissioner's consent at any time before the end of the period prescribed for claiming a credit or refund of taxes for the year for which the election is made.

You can revoke the initial election if the credit or refund period has not expired. If you make a proper and timely revocation, you can make the initial election of the overall limitation for a later taxable year without the Commissioner's consent.

Once you have made the initial election and the period prescribed for making such election has expired, you cannot revoke the initial election without the Commissioner's consent.

Members of an affiliated group electing the 100% dividends-received deduction under section 243(b) are treated as one taxpayer for purposes of electing the overall limitation.

H. When foreign tax credit can be taken.

You can take the credit for the year in which the taxes were paid or accrued depending on the method of accounting used. However, if you report on the cash basis, you can elect to claim the credit for accrued taxes. You can make the election by checking the appropriate box in the heading for column 2 of Schedule A. This election must be followed in all subsequent years. (Section 905(a).)

I. Credit for tax accrued but not paid.

If you claim a credit for tax accrued but not paid, Internal Revenue may require you to furnish a bond on Form 1117 as a condition precedent to the allowance of the credit. (Section 1.905-4 of the regulations.)

J. Special limitation for certain (1) interest income and (2) dividends from a DISC or former DISC.

In computing the credit for (1) foreign tax paid or accrued on certain interest income and (2) tax deemed paid with respect to dividends from a DISC or former DISC, the limitation is to be applied separately from all other income and must be applied on a per-country basis. The overall limitation cannot be used. This applies to interest income described in section 904(f)(2) and dividends from a DISC or former DISC (as defined in section 992(a)) to the extent the dividends are treated as income from sources without the U.S.

If you receive dividends from a DISC or former DISC, as described in section 904(f)(1)(B), for the taxable year from more than one corporation, the per-country limitation is applied to the aggregate of the dividends. (Section 904(f)(5).)

K. Foreign corporations claiming foreign tax credit.

Section 906 allows foreign corporations a foreign tax credit for income, war profits, and excess profits tax paid or accrued (or deemed paid or accrued under section 902) to any foreign country or U.S. possession with respect to income effectively connected with the conduct of a trade or business within the U.S. The credit is not applicable, however, to the extent the tax is imposed by a foreign country or possession on income from U.S. sources solely because the foreign corporation was created or organized under the law of the foreign country or possession or is domiciled there for tax purposes.

In applying the per-country and overall limitations, taxable income includes only that taxable income which is effectively connected with the conduct of a trade or business within the U.S.

The credit cannot be taken against any tax imposed by section 881 on income not effectively connected with a U.S. business.

For purposes of section 901(a) (relating to tax deemed to have been paid) and section 78 (relating to gross-up of dividends), a foreign corporation claiming a foreign tax credit will be treated as a domestic corporation.

In applying the foreign tax credit carryback and carryover provisions of section 904, no amount can be carried to or from a taxable year beginning before 1967, and no such year will be taken into account.

L. Foreign taxes on mineral income.

For taxable years beginning after 1969, section 901(e) provides that, for purposes of section 901(b), the amount of foreign tax paid or accrued to a foreign country or U.S. possession with respect to foreign mineral income from sources within such country or possession must be reduced by the lesser of (a) the amount of the tax minus the amount of U.S. tax computed under Chapter 1 of the Code with respect to the foreign mineral income, or (b) the amount of U.S. tax which would be computed under Chapter 1 of the Code with respect to the income without the deduction allowed under section 613 minus the amount of U.S. tax computed under Chapter 1 of the Code with respect to the income.

If the above provisions apply, complete column 9 of Schedule A on a country by country basis. The total tax that would otherwise be shown on each line in column 9, Schedule A, must first be reduced by the lesser of (a) or (b) above. Attach a schedule showing the computation of the net amount to be entered on each line in column 9, Schedule A, after applying section 901(e). Also, write in the heading of column 9, Schedule A, "see attachment."

Specific instructions for Schedules A through D Schedule A

Column 2.—If you claim a credit for taxes accrued, show both the date accrued and the date paid (if paid). See instruction H.

Column 3.—Enter the type of tax (income, war profits, or excess profits).

Column 5.—Enter amounts in columns 5(a), (b), and (c) in U.S. dollars. Complete columns 5(a), (b), and (c) for each country imposing the tax regardless of the method used in computing the limitation. In-

clude all income that is taxable (less losses that are allowable) by the U.S. whether or not taxable (or allowable) by the foreign country or U.S. possession. The computation of taxable income from sources without the U.S. must be made in accordance with sections 638 and 861 through 864, and must be made without deduction of any income or profits tax imposed by any foreign country or U.S. possession.

The schedule requested in columns 5(a) and (b) should categorize the type of gross income and expenses as follows: interest, royalties, branch income, dividends, and other.

Note: If an amount on any line in column 5(c) is a loss, you are required to complete that line through column 9.

If you elect the overall limitation, all income from sources without the U.S. is taken into account. Thus, income from sources without the U.S. includes high seas income but such income is not taken into account under the per-country limitation. Where high seas income is taken into account, it should be properly identified and shown on the schedule.

For dividends from a foreign corporation 50% or more of whose gross income was effectively connected with the conduct of a trade or business within the U.S., see section 861(a)(2)(B).

Gross-up of dividends.—Include in income as a "dividend gross-up," taxes deemed paid (Schedule B, column 11) on (1) actual or constructive distributions by a foreign corporation out of accumulated profits of a year for which the foreign corporation was not a less developed country corporation and (2) deemed or actual distributions from a DISC or former DISC.

Column 6.—Include tax withheld at the source on dividends and other tax paid or accrued. Do not include tax deemed to have been paid by a related corporation as shown in column 7.

If you have foreign mineral income, see instruction L.

Column 6(a).—State the amount in the currency of the foreign country (e.g., pounds, francs, marks).

Column 6(b).—Give the rate of exchange used and attach a statement describing in reasonable detail why and how you determined the rate used.

Column 6(c).—Regardless of

whether you elected the per-country limitation or the overall limitation, a separate computation and entry will be necessary for each country.

Column 7.—Regardless of whether you elected the per-country limitation or the overall limitation, enter the tax deemed to have been paid to the individual foreign country or U.S. possession from Schedule B except for tax deemed paid with respect to dividends from a DISC or former DISC.

Enter the total foreign tax deemed paid with respect to dividends from a DISC or former DISC (identified separately in column 11, Schedule B) on the "DISC Dividends" line.

If you have foreign mineral income, see instruction L.

Column 8.—Attach a schedule showing a computation of the carryback or carryover. If you elected the per-country limitation, a separate computation and entry will be necessary for each country. If you elected the overall limitation, enter the total carryback or carryover on the total line.

Taxes paid or accrued to any foreign country or U.S. possession in excess of the applicable limitation can be carried back 2 years and then carried forward 5 years. The excess must first be applied to the earliest of the 7 years to which it may be carried, then to the next earliest year, etc. The excess cannot be carried from a per-country year to an overall year or vice versa. However, the years to which you cannot carry the excess because you used a different limitation are counted in determining whether a carryback or carryover is available.

If you claim a deduction rather than a credit in any taxable year to which the carryback or carryover is carried, the carryback or carryover is to be considered used in such year in the same manner as though you had claimed the tax credit, instead of a deduction, but no credit is allowed for the amount so used.

Column 9.—If you elected the per-country limitation, columns 6(c), 7, and 8 must be totaled across line by line. If you elected the overall limitation, use only the total line.

If you have foreign mineral income, see instruction L.

Column 10.—If you elected the per-country limitation, enter on each line for each country for which the

credit is claimed the total U.S. income tax before credits. If you elected the overall limitation, enter the amount on the total line only.

Column 11.—If you elected the per-country limitation, enter on each line for each country for which the credit is claimed the total taxable income (after net operating loss deduction and special deductions) from all sources. If you elected the overall limitation, enter the amount on the total line only.

For foreign corporations claiming the credit, taxable income includes only that taxable income which is effectively connected with the conduct of a trade or business within the U.S.

Column 12.—If you elected the per-country limitation, the ratio of foreign taxable income (column 5(c)) to taxable income from all sources (column 11) must be computed for each country. (Divide the amount in column 5(c) by the amount in column 11 for each line.)

If you elected the overall limitation, the ratio is computed on the total line only. (Divide the total of column 5(c) by the amount entered in the total line for column 11.)

In computing the ratio, the numerator cannot exceed the denominator. See instruction G.

Column 13.—If you elected the per-country limitation, the limitation must be computed for each country. (Multiply the amount in column 10 by the amount in column 12 for each line.)

If you elected the overall limitation, the limitation is computed on the total line only. (Multiply the amount in the total line for column 10 by the amount in the total line for column 12.)

If you elected the overall limitation, special limitations apply to consolidated returns which include a Western Hemisphere trade corporation. See section 1503(b).

Column 14.—If you elected the per-country limitation, enter for each country the amount in column 9 or column 13, whichever is less. The credit to be claimed on your income tax return will be the total of the individual credits in column 14.

If you elected the overall limitation, enter on the total line the total amount in column 9 or column 13, whichever is less.

Schedule B

Column 2.—If dividends are from the gains, profits, and income of more than 1 year, the tax deemed to have been paid must be computed and shown on a separate line for each year.

Column 4.—The gains, profits, and income to be entered is determined by the gains, profits, and income from all sources, whether or not subject to foreign tax, for the year from which the dividends (column 7) were paid. Include all dividends received from a foreign subsidiary of the related foreign corporation.

Internal Revenue may determine from which year's accumulated profits the dividends were paid. In making the determination, Internal Revenue will, unless it is otherwise established to its satisfaction, treat any dividends which are paid in the first 60 days of any taxable year as having been paid from the accumulated profits of the preceding taxable year or years and will treat dividends which are paid after the first 60 days of any taxable year as having been paid from the most recently accumulated profits.

The conversion to dollars must be made at the same exchange rate used for dividends in column 7.

Column 7.—Enter the amount of dividends (1) paid or constructively distributed by the related foreign corporation to the domestic corporation, (2) paid by the related domestic corporation to the domestic corporation, and (3) paid or deemed distributed by the DISC or former DISC to the domestic corporation.

Column 8.—For dividends paid by a foreign corporation out of accumulated profits of a year for which the foreign corporation was a less developed country corporation, disregard the instruction in the column heading and enter the amount determined by dividing column 6 by column 4 and multiplying the result by column 5.

Column 11.—Regardless of whether you elected the per-country limitation or the overall limitation, the amount entered in this column, excluding any amount from a corporation that is a DISC or former DISC, should be carried to Schedule A, column 7 and entered on the line with the country or U.S. possession for which you are claiming a credit.

Since a separate limitation must be applied to foreign tax deemed

paid in respect to dividends from a DISC or former DISC, any amount included in the total of this column from a DISC or former DISC should be entered in total on the "DISC Dividends" line of Schedule A, column 7.

Schedule C

If a related foreign corporation (first foreign corporation) in Schedule B owns 10% or more of the voting stock of a second foreign corporation from which it receives dividends, Schedule C must be filled in to determine the tax deemed to have been paid by the first foreign corporation. See instruction F(2).

Column 1.—Enter the name of the second foreign corporation.

Columns 2 and 4.—Same instructions as Schedule B.

Column 7.—Enter the amount of dividends paid by the second foreign corporation to the first foreign corporation.

Column 11.—Carry the amount of tax deemed to have been paid to Schedule B, column 9 and enter on the line with the related first foreign corporation. If dividends are paid from the gains, profits, and income of more than 1 year, the tax deemed to have been paid by the first foreign corporation must be computed separately for each year.

Schedule D

If the second foreign corporation in Schedule C owns 10% or more of the voting stock of a third foreign corporation from which it receives dividends, Schedule D must be filled in to determine the tax deemed to have been paid by the second foreign corporation. See instruction F(3).

Column 1.—Enter the name of the third foreign corporation.

Columns 2 and 4.—Same instructions as Schedule B.

Column 7.—Enter the amount of dividends paid by the third foreign corporation to the second foreign corporation.

Column 10.—Enter the amount from column 8.

Column 11.—Carry the amount of tax deemed to have been paid to Schedule C, column 9 and enter on the line with the related second foreign corporation. If dividends are paid from the gains, profits, and income of more than 1 year, the tax deemed to have been paid by the second foreign corporation must be computed separately for each year.