

# Instructions for Form 1118

## (Revised February 1985)

### Computation of Foreign Tax Credit—Corporations

(Section references are to the Internal Revenue Code unless otherwise noted)

**Paperwork Reduction Act Notice.**— We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

#### Important Changes You Should Note

The Tax Reform Act of 1984 (Act) made several changes to the way corporations compute their foreign tax credit. Some of these involved changing sources of income, which were formerly considered foreign, to domestic. Other changes set up rules for defining the source of factoring income and income from transportation services. Also, the allocation rules for certain research and experimental expenditures were extended.

A short description of each section follows.

**A.** Section 904(g) was added to the Code by section 121 of the Act. Section 904(g) requires that certain income, which was formerly considered foreign sourced, be considered U.S. sourced. This is income from a U.S.-owned foreign corporation that is subpart F income, foreign personal holding company income, interest income, or dividend income.

The U.S. shareholder's portion of subpart F and foreign personal holding company income that must be considered U.S. sourced is the portion of either income that is attributable to the foreign corporation's U.S. sourced income.

Interest received by a shareholder or a person related to the shareholder of a U.S.-owned foreign corporation is U.S. sourced income to the extent that the interest is properly allocable to the corporation's U.S. sourced income.

The amount of the dividend paid to a shareholder in a U.S.-owned foreign corporation that is U.S. sourced income is the dividend multiplied by the earnings and profits of the corporation for the tax year attributable to U.S. sources, divided by total earnings and profits for the tax year.

U.S.-owned foreign corporations whose earnings and profits are less than 10% U.S. sourced income for the tax year are exempt from the interest and dividend provisions of section 904(g). (Section 904(g)(5).)

Section 904(g) generally applies to income received or accrued by the U.S.-owned foreign corporation after July 18, 1984. However, see section 121(b) of the 1984 Act for certain exceptions.

**B.** Section 904(d)(3) was added to the Code by section 122 of the Act. Section 904(d)(3) requires that certain amounts paid by a designated payor corporation be considered interest by the payee when computing the foreign tax credit. A designated payor corporation is any U.S.-owned foreign corporation, any other foreign corporation in which the payee is a U.S. shareholder (as described in section 951(b)), and any regulated investment company. The amount that is treated as interest under this Code section is the amount of interest and dividends that does not exceed the separate limitation interest of the payor corporation. The separate limitation interest of the payor corporation is the interest described in section 904(d)(2) received by the corporation and the amount of dividends required to be included under section 904(d)(3), less applicable deductions. Generally, section 904(d)(3) applies to interest and dividends paid or accrued after July 17, 1984. However, see section 122(b)(2) of the Act for special rules for interest income.

**C.** Section 864(d) was added to the Code by section 123 of the Act. Section 864(d) defines "factoring income" and shows how to determine the source of "factoring income." "Factoring income" is derived when a person acquires a trade or service receivable from a related person. "Factoring income" is earned by the related person when it collects the receivable. Section 864 states that "factoring income" shall be treated by the person acquiring the receivable as interest on a loan to the obligor of the receivable. "Factoring income" is treated as interest on a loan to the obligor for source of income rules, and the income is included in section 904(d) income when computing the foreign tax credit.

See section 864(d) of the Code and section 123(d) of the Act for more rules and exceptions.

**D.** Section 863(c) was added to the Code by section 124 of the Act. The new Code section defines the source of income from transportation services that begin and end in the United States as 100% U.S. sourced income. Additionally, the Code section defines the source of income from transportation between the United States and a U.S. possession as being 50% U.S. sourced and 50% possession sourced. The new rules apply to transportation that begins after July 18, 1984.

**E.** Section 126 of the Act extends for 2 years the rule that research and experimental expenditures for research activities in the United States are considered U.S. sourced.

**F.** Section 904(d)(1) of the Code was amended by section 801(d)(2) of the Act to provide for two additional categories of income subject to a separate limitation for foreign tax credit purposes. These new limitations are for foreign trade income of a Foreign Sales Corporation (FSC) and for distributions from a FSC or former FSC. This provision is effective for tax years ending after 1984.

#### General Instructions

**A. Corporations Required to File Form 1118.**—Every corporation that elects the benefits of the foreign tax credit under section 901 must attach Form 1118 to its income tax return. The form must be carefully filled in with all the information called for and with the calculation of credits indicated. (Section 1.905-2(a)(2) of the regulations.)

**Note:** A regulated investments company that has made an election under section 853 cannot claim the foreign tax credit (or deduction). (Section 853(b)(1).)

**B. Foreign Taxes for which Credit May Be Claimed.**—The credit may be claimed for income, war profits, and excess profits taxes paid or accrued during the tax year to any foreign country or to any U.S. possession, and for taxes deemed paid or accrued under sections 902 and 960. (Section 1.901-1(a)(2) of the regulations.)

The term "foreign country" means any foreign state or possession of the U.S., or political subdivision or agency or instrumentalality of a foreign state or U.S. possession. (Section 1.901-2(g) of the regulations.)

See section 1.901-2 of the regulations for a definition of income, war profits, or excess profits taxes. Also, see section 1.903-1 of the regulations for a definition of taxes paid in lieu of income taxes.

Any income, war profits, and excess profits taxes paid or accrued to any foreign country in connection with the purchase and sale of oil or gas extracted in such country is not to be considered a tax for purposes of sections 275(a) and 901 if: (1) the taxpayer has no economic interest in the oil or gas to which section 611(a) applies; and (2) either such purchase or sale is at a price which differs from the fair market value for such oil or gas at the time of such purchase or sale. (Section 901(f).)

Foreign taxes paid or accrued on foreign oil related income do not qualify for the foreign tax credit if the Secretary determines that the foreign law is designed, or operates, to impose a greater tax on foreign oil related income than the tax that is generally imposed on income that is neither foreign oil related income nor foreign oil and gas extraction income. Taxes not allowed as a credit under this rule will, however, be allowed as a deduction. (Section 907(b).)

No credit (or deduction) is allowed for any tax paid or accrued to a foreign country or U.S. possession with respect to taxable income used in computing the section 936 credit. (Section 936(c).)

No credit is allowed for taxes paid or accrued by a FSC on foreign trade income (other than non-exempt foreign trade income determined without regard to administrative pricing rules.) (Section 901(h).)

No credit (or deduction) is allowed for any tax paid or accrued to a foreign country or U.S. possession with respect to any distribution from a corporation to the extent the distribution is attributable to periods during which the corporation is a possessions corporation, and a dividends received deduction is allowable with respect to the distribution, or to the extent that the distribution is received in connection with a liquidation or other transaction in which gain or loss is not recognized. (Section 901(g).)

No credit (or deduction) is allowed for any income, war profits, or excess profits taxes paid or accrued to any foreign country or U.S. possession attributable to income excluded under section 814.

A credit is not allowed for excess tax payments to a foreign country with which the U.S. has a tax treaty if such excess would be refunded by the foreign country under a tax treaty or overpayment claim.

No credit is allowed for amounts representing interest or penalties.

For reduction in the amount of foreign taxes for which a credit may be claimed, see General Instructions I and N.

**C. Taxes Against Which Credit is Allowed.**—The foreign tax credit is allowed against income tax imposed by chapter 1 (reduced by the section 936 credit) but not against any: (1) minimum tax 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 for the tax year under section 1351 (relating to recoveries of foreign expropriation losses); (5) increase in tax under section 47 (relating to dispositions of investment credit property); and (6) tax on electing small business corporations imposed by sections 1374 or 1375.

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. (Section 906(b)(3)).

**D. No Deduction if a Credit is Claimed.**—If a corporation elects for any tax year to claim a credit for taxes to any extent, the

election will apply to income, war profits, and excess profits taxes paid or accrued in the tax year to all foreign countries and U.S. possessions and no portion of the tax will be allowed as a deduction in the tax year or any succeeding tax year. (Section 1.901-1(c) of the regulations.)

The election for any tax 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 tax year. (Section 901(a).)

See section 908(b) concerning the deductibility of the amount of the foreign tax credit lost because of the application of the international boycott provisions. Also, see section 907(b) concerning the deductibility of certain foreign oil and gas extraction taxes.

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 the election under section 901(a). (Section 243(b)(3)(B).)

**E. 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 1 of Schedule B. This election must be followed in all subsequent years. (Section 905(a).)

**F. Credit for Tax Accrued But Not Paid.**—If you claim a credit for tax accrued but not paid, the Internal Revenue Service 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.)

**G. Proof of Credits.**—Payment or accrual of each item of foreign tax for which you claim a credit must be substantiated by attaching to Form 1118 a receipt if the tax is paid, or the foreign tax return on which the tax is based if the tax is accrued but not paid. If such receipt or return is in a foreign language, a certified translation must also be attached. IRS may accept secondary evidence of foreign taxes paid or accrued if it can be established to its satisfaction that it is impossible to furnish a receipt, return, or direct evidence of tax withheld. (Section 1.905-2 of the regulations.)

Foreign taxes paid or accrued by a foreign corporation for which a deemed paid credit is claimed under section 902 or 960 must be similarly substantiated. (Secs. 1.902-1(j) and 1.960-1(e) of the regulations.)

If you are claiming as part of your foreign tax credit any foreign taxes paid or accrued that resulted from an audit adjustment by the foreign taxing authority, attach a statement to Form 1118 identifying these taxes.

**H. Credit for Taxes of Foreign Corporations Deemed to Have Been Paid (See Schedules C, D, and E).**—

(1) *Under Section 902.*—If a domestic corporation owns 10% or more of the voting stock of a foreign corporation (first-tier

foreign corporation) from which it receives a dividend, the domestic corporation is deemed to have paid a proportionate amount of the foreign income, war profits, and excess profits taxes paid, accrued, or deemed paid by the first-tier foreign corporation. (Section 902(a).)

If the first-tier corporation owns 10% or more of the voting stock of a second-tier foreign corporation from which it receives a dividend, and the product of the percentage of voting stock owned by the domestic corporation in the first-tier foreign corporation and the percentage of voting stock owned by the first-tier foreign corporation in the second-tier foreign corporation equals at least 5%, the first-tier foreign corporation is deemed to have paid a proportionate amount of the foreign income, war profits, and excess profits taxes paid, accrued or deemed paid by the second-tier foreign corporation. (Sec. 902(b)(1).)

If the second-tier foreign corporation owns 10% or more of the voting stock of a third-tier foreign corporation from which it receives a dividend, and the product of the percentage of voting stock owned by the domestic corporation in the first-tier foreign corporation, the percentage of voting stock owned by the first-tier foreign corporation in the second-tier foreign corporation and the percentage of voting stock owned by the second-tier foreign corporation equals at least 5%, the second-tier foreign corporation is deemed to have paid a proportionate amount of the foreign income, war profits, and excess profits taxes paid or accrued by the third-tier foreign corporation. (Section 902(b)(2).)

You may not claim a credit under section 902 for taxes paid by a registered foreign investment company to which the election under section 1247(f) applies. (Section 1.1247-4(b)(vii) of the regulations.)

For purposes of section 904, all foreign income taxes paid or deemed paid by a first-tier foreign corporation and deemed paid by the domestic corporation under section 902, are deemed to have been paid to the foreign country or U.S. possession under the laws of which such first-tier foreign corporation is created or organized. (Section 1.902-1(h)(2) of the regulations.)

(2) *Under Section 960(a).*—If a domestic corporation is required under section 951 to include in gross income an amount attributable to the earnings and profits of a foreign corporation (first-tier foreign corporation) of which it owns 10% or more of the voting stock, or of a foreign corporation (second-tier foreign corporation) of which such first-tier foreign corporation owns 10% or more of the voting stock, the domestic corporation is deemed to have paid a proportionate amount of the foreign income, war profits, and excess profits taxes paid, accrued, or deemed paid by such first-tier foreign corporation, or paid or accrued by such second-tier foreign corporation.

For amounts included in gross income under section 951, a credit is allowed for taxes deemed to have been paid by a third-tier foreign corporation, and the percentage-of-voting-stock requirements are the same as under section 902(b)(3)(B).

**(3) Mixed Application of Sections 902 and 960(a).**—Section 902(b)(1) applies to all dividends received by a first-tier foreign corporation from a second-tier foreign corporation (as defined for purposes of section 960(a)) other than dividends attributable to earnings and profits of such second-tier foreign corporation in respect of which an amount is, or has been, included in the gross income of a domestic corporation under section 951 with respect to such second-tier foreign corporation. (Section 1.960-2(b) of the regulations.)

Section 902(a) applies to all dividends received by the domestic corporation for its tax year from a first-tier foreign corporation, other than dividends attributable to earnings and profits of such first-tier foreign corporation in respect of which an amount is, or has been, included in the gross income of a domestic corporation under section 951 with respect to such first-tier foreign corporation. (Section 1.960-2(c)(d) of the regulations.)

If a first-tier foreign corporation for its tax year receives from a second-tier foreign corporation (as defined for purposes of section 960(a)) dividends to which section 902(b)(1) applies and other dividends to which section 902(b)(1) does not apply, then in applying sections 902(a) and 960(a) with respect to the foreign income taxes deemed paid under section 902(b)(1) by such first-tier foreign corporation for such tax year, the earnings and profits of the first-tier foreign corporation shall be considered not to include its earnings and profits attributable to such other dividends from the second-tier foreign corporation, and for the purposes of so applying section 902(a), distributions to the domestic corporation from such earnings and profits which are attributable to such other dividends from the second-tier foreign corporation shall not be treated as a dividend. (Section 1.960-2(d) of the regulations.)

Computations under section 902 must also make allowance for any taxes deemed to have been paid by a third-tier foreign corporation under section 960(a).

**(4) Entities Treated As Foreign.**—For purposes of the deemed paid credit, the term “foreign corporation” includes: (1) a DISC or former DISC (as defined in section 992(a)), but only with respect to dividends from the DISC or former DISC to the extent such dividends are treated under sections 861(a)(2)(D) and 862(a)(2) as income from sources without the U.S.; and (2) a contiguous country life insurance branch, where an amount is added to the life insurance taxable income of the domestic life insurance company by reason of section 814A(e)(2). (Secs. 901(d) and 814A(f)(1).)

**(5) Dividend Gross-up.**—Under section 78, taxes deemed paid by a domestic corporation under sections 902 and 960(a) with respect to distributions by a foreign corporation must be included in income as dividend gross-up. (See section 1.960-3(b) of the regulations for exceptions.)

## **I. Reduction in Foreign Taxes.—**

**(1) Taxes on Foreign Oil and Gas Extraction Income.**—The amount of any foreign taxes paid, accrued, or deemed paid with respect to foreign oil and gas extraction income which may be taken into account for purposes of section 901 must be reduced by the amount (if any) by which the amount of such taxes exceeds the product of the amount of foreign oil and gas extraction income for such tax year and the applicable percentage from section 907(a)(2). (Section 907(a).)

See section 907(c)(4) for the rules regarding the recharacterization of foreign oil and gas extraction losses for tax years beginning after 1982.

For computation of the reduction, see separate Schedule F, Form 1118.

**(2) Taxes on Foreign Mineral Income.**—The amount of any income, war profits, and excess profits taxes paid or accrued, or deemed paid during the tax year to any foreign country or U.S. possession with respect to foreign mineral income derived from sources within such country or possession must be reduced by the lesser of (a) the amount of such foreign taxes minus the amount of U.S. tax computed under Chapter 1 of the Code with respect to such foreign mineral income, or (b) the amount of U.S. tax which would be computed under Chapter 1 of the Code with respect to such foreign mineral income without regard to the deduction for percentage depletion under section 613 minus the amount of U.S. tax computed under Chapter 1 of the Code with respect to such foreign mineral income. The reduction must be made on a country-by-country basis. (Section 1.901-3(a)(1) of the regulations.)

The reduction applies only if a deduction for percentage depletion under section 613 was allowed with respect to any part of such foreign mineral income. (Section 1.901-3(a)(3)(i) of the regulations.)

A schedule must be attached showing the computation described in (a) and (b) above of the foreign and U.S. tax with respect to foreign mineral income. (Section 1.901-3(a)(3)(iv) of the regulations.)

**(3) Failure To Furnish Return Required Under Section 6038 (Form 5471 and Schedule M).**—For each failure of a domestic corporation to furnish any return or any information in any return required under authority of section 6038 by the prescribed date, in the application of sections 902 and 960, all taxes paid or deemed paid by all foreign corporations controlled by such domestic corporation must be reduced by 10%, and in the application of section 901, all taxes paid or deemed paid (except taxes deemed paid under section 904(d) and taxes reduced in the application of sections 902 and 960) by such corporation must be reduced by 10%. If such failure continues for 90 days or more after the date of written notice by IRS to such domestic corporation, the reductions are 10% plus 5% for each three-month period or fraction thereof during which such failure continues after expiration of the 90-day period.

A penalty of \$1,000 is also imposed for failing to supply the information for each controlled foreign corporation under section 6038 when required. Additionally, if the required information is not submitted within 90 days after the Secretary has mailed notice to the U.S. person, an additional \$1,000 penalty (per corporation) is charged for every 30 days that the information is not submitted. The increase in any penalty under section 6038(b)(2) may not exceed \$24,000. See section 6038(c)(3) for rules coordinating these penalties.

## **J. Limitation on Credit.—**

The credit must be computed using the overall limitation. Under the overall limitation, the credit is limited to that percentage of the total U.S. income tax against which the credit is allowed which taxable income from sources without the U.S. (but not in excess of total taxable income) is of total taxable income. (Section 904(a).)

The credit must be computed separately (using a separate Form 1118) for foreign taxes paid or accrued with respect to: (1) section 904(d) interest income; (2) dividends from a DISC or former DISC; (3) foreign trade income of a FSC; (4) distributions of a FSC or former FSC; and (5) all other income from sources without the U.S. On each Form 1118, the credit must be computed using the overall limitation.

The limitation may be increased under section 960(b) in a tax year in which you receive a distribution of earnings and profits in respect of which you were required under section 951 to include an amount in gross income for a prior tax year. See section 960 and section 1.960-4 of the regulations for computation of the increase in the limitation.

## **K. Computation of Taxable Income.—**

**(1) General Source Rules.**—Determine gross income, applicable deductions, and taxable income from sources without the U.S. and within each foreign country or U.S. possession in accordance with sections 638 and 861 through 864 and the related regulations, and applicable tax treaties. All income from sources without the U.S., including high seas income, must be taken into account.

Also, see paragraphs A through D of “Important Changes You Should Note” for new rules concerning sources of certain income.

**(2) Capital Gains.**—Taxable income from sources without the U.S. includes gain from the sale or exchange of capital assets (including any gain so treated under section 1231) only in an amount equal to foreign source capital gain net income (lesser of capital gain net income from sources without the U.S. or capital gain net income from all sources) reduced by the “rate differential portion” of foreign source net capital gain (lesser of net capital gain from sources without the U.S. or net capital gain).

See section 904(b)(3)(F) for a definition of "rate differential portion."

For purposes of the credit, taxable income from all sources includes gain from the sale or exchange of capital assets only in an amount equal to capital gain net income reduced by the "rate differential portion" of net capital gain. (See above.)

Any net capital loss including any amount that is a short-term capital loss under section 1212(a) from sources outside the U.S., to the extent taken into account in determining capital gain net income, is reduced by the "rate differential portion" of the excess of net capital gain from sources within the U.S. over net capital gain.

Generally, the term "capital gain net income" means the excess of the gains from the sales or exchanges of capital assets over the losses from such sales or exchanges.

See section 904(b)(3)(C) for gain from sources without the U.S. treated as gain from sources within the U.S. in the case of sales or exchanges of certain personal property. However, see section 904(b)(3)(D) for exceptions to this rule with respect to distributions in liquidation of certain foreign corporations.

**(3) Recapture of Foreign Losses.**— Generally, if in any tax year you sustain an overall foreign loss, then in each succeeding tax year you must treat as income from sources within the U.S. a portion of your taxable income from sources without the U.S. That portion is the lesser of: (a) the amount of the overall foreign loss not recaptured in prior years; or (b) 50% (or any higher percentage you choose) of your taxable income from sources without the U.S. Generally, an "overall foreign loss" is the amount by which gross income from sources without the U.S. is exceeded by the total deductions applicable to such income. However, see section 904(f) for certain losses not taken into account and special rules governing dispositions of property used predominantly outside the U.S. in a trade or business.

The recapture rules are applied separately to each category of income listed in instruction J- (1) section 904(d) interest; (2) dividends from a DISC or former DISC; (3) foreign trade income of a FSC; (4) distributions from a FSC or former FSC; and (5) all other income from sources outside the U.S. For tax years beginning before 1983, there was a separate limitation for foreign oil related income. However, the Tax Equity and Fiscal Responsibility Act of 1982 eliminated this separate limitation and merged foreign oil related income with "all other income from sources without the U.S." for tax years beginning after 1982. See section 211(e) of the Tax Equity and Fiscal Responsibility Act of 1982 and section 306(a)(5) of the Technical Corrections Act of 1982 and section 712(e) of the Tax Reform Act of 1984 for transitional rules concerning the recapture of pre-1983 foreign oil related losses out of "all other income from sources outside the U.S.," and the recapture of losses from "all other income outside the U.S." out of foreign oil related income.

**(4) Coordination with section 936.**— Taxable income used in computing the section 936 credit is excluded from taxable income in computing the foreign tax credit limitation. (Section 904(b)(4).)

**(5) Foreign Corporations Claiming Credit.**—For purposes of computing the foreign tax credit limitation, taxable income includes only taxable income that is effectively connected with the conduct of a trade or business within the U.S. (Section 906(b)(2).)

**L. Carryback and Carryover of Excess Taxes Paid.**—

Taxes paid or accrued, or deemed paid under sections 902 and 960, to any foreign country or U.S. possession (reduced as described in General Instruction I) in excess of the applicable limitation may be carried back 2 years and then 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. (Section 904(c).)

If a credit was not claimed in a tax year to which the excess is carried, the excess is considered used in such year in the same manner as though a credit had been claimed. (Section 1.904-2(c) of the regulations.)

The carryback and carryover provisions must be applied separately to the excess with respect to: (1) Section 904(d) interest income; (2) dividends from a DISC or former DISC; (3) foreign trade income of a FSC; (4) distributions from a FSC or former FSC; and (5) all other income from sources without the U.S. (Sections 904(d)(1) and 907(b).)

See sections 907(e) and 907(f) for rules governing the carryback and carryover of related taxes and foreign oil and gas extraction taxes paid or accrued in excess of the section 907(a) limitation.

**M. Foreign Corporations Claiming Foreign Tax Credit.**—Section 906 allows foreign corporations a foreign tax credit for income, war profits, and excess profits taxes 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, if the tax is imposed by a foreign country or U.S. possession on income from U.S. sources solely because the foreign corporation was created or organized under the law of the foreign country or U.S. possession or is domiciled there for tax purposes.

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 902(a) (relating to tax deemed paid) and section 78 (relating to dividend gross-up), a foreign corporation claiming a foreign tax credit will be treated as a domestic corporation.

**N. Reduction of Credit for International Boycott Operations.**—Generally, if a person or any corporation controlled by that person agrees to participate in, or cooperate with an international boycott, that person must file Form 5713 and reduce the total taxes available for credit or the credit otherwise allowable.

If the taxes specifically attributable to boycott operations can be determined, reduce the total taxes available for credit by entering this amount on Schedule B, Part II, line 3.

However, if the above determination cannot be made, compute the reduction by multiplying the credit otherwise allowable by the international boycott factor. This reduction shall be made against the credit otherwise allowable and entered on Schedule B, Part III, line 7.

For additional information, see Form 5713 and the Instructions for Form 5713.

**O. Method of Reporting.**—Report all amounts in U.S. dollars. If it is necessary to convert from foreign currency, attach a statement explaining how you determined the rate.

**P. Research and Experimental Expenditures.**—Section 126 of the Tax Reform Act of 1984 provides that for tax years beginning after August 13, 1983, and on or before August 1, 1985, all research and experimental expenditures paid or incurred in those years for research activities conducted in the U.S. shall be considered as allocable to U.S. sources.

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## Specific Instructions for Schedules A through E

### Schedule A.—Taxable Income or (Loss) from Sources Without the U.S.

All applicable columns in Schedule A must be completed line by line including the "Totals" line.

In columns 2 through 9 report all gross income or (loss) from sources without the U.S. except: (1) gross income of foreign branches; and (2) gross income from activities described in section 863(b). In columns 11 and 12 report all deductions applicable to gross income reported in columns 2 through 9. See the instructions for columns 14 and 15 for treatments of income of foreign branches and section 863(b) income, respectively.

Report only gross income and deductions applicable to the determination of taxable income or (loss) from sources without the U.S. of the type for which Form 1118 is being completed.

Column 1.—Enter the names of all foreign countries and U.S. possessions within which income is sourced, and/or to which taxes are paid, accrued, or deemed paid.

High seas income must be shown separately and be properly identified.

**Column 2.**—Report all dividends (before gross-up) from sources without the U.S., including constructive distributions under section 951. See section 861(a)(2)(A) for treatment of dividends from a domestic corporation which has an election in effect under section 936 and from other domestic corporations less than 20 percent of whose gross income is derived from sources within the U.S. See section 861(a)(2)(B) for treatment of dividends from a foreign corporation 50 percent or more of whose gross income was effectively connected with the conduct of a trade or business within the U.S.

**Column 3.**—Enter the dividend gross-up for taxes deemed paid. See General Instruction H(5) for an explanation.

**Column 4.**—If interest is excluded from section 904(d) interest by virtue of section 904(d)(2)(C) or (D), attach a schedule showing in detail the manner in which the 10% direct or indirect ownership requirements are met.

**Column 6.**—Include gross income, whether in the form of compensation, commissions, fees, or otherwise derived from the performance of technical, managerial, engineering, construction, scientific or similar services. Do not include gross income from services performed through a foreign branch.

**Column 7.**—If there is gain on the sale or exchange of capital assets from sources outside the U.S., enter the entire amount of the gain in column 7. Also, see the instruction for column 11(d).

If there is a net capital loss or short-term capital loss from sources outside the U.S., see instruction K(2) for the reduction required in certain cases.

**Column 9.**—Include all other gross income from sources without the U.S., except gross income of foreign branches and gross income from activities described in section 863(b). Attach a schedule identifying the gross income by type and by foreign country or U.S. possession of source.

**Column 11(d).**—Include all other deductions definitely allocable to income from sources without the U.S. (dividends, interest, etc.) except deductions allocable to income of foreign branches and section 863(b) income.

Report the reduction of foreign source net capital gain here. (See instruction K(2).)

**Column 12.**—Section 862(b) provides that a ratable part of expenses, losses, and other deductions which cannot definitely be allocated to some item or class of gross income shall be deducted from gross income from sources without the U.S. in arriving at taxable income from sources without the U.S. Report in column 12

only that ratable part which applies to gross income reported in columns 2 through 9. Attach a schedule showing in detail the determination of this ratable part.

**Column 14.**—Attach a schedule showing in detail the determination of taxable income or (loss) of each foreign branch. Include, for each foreign branch, an income statement, balance sheet, and schedule of midyear remittances.

**Column 15.**—Section 863(b) and the regulations thereunder provide special rules for determining taxable income from sources without the U.S. with respect to gross income derived partly within and partly without the U.S. Report in column 15 taxable income or (loss) apportioned to sources without the U.S. under these special rules. (Taxable income of foreign branches from sources without the U.S. determined under these special rules should be reported in column 14, not column 15.) Attach a schedule showing gross income, definitely allocable deductions, the ratable part of deductions not definitely allocable, and the apportionment of taxable income to sources within and without the U.S.

## Schedule B

### Part I.—Foreign Taxes Paid or Accrued and Deemed to Have Been Paid

All applicable columns in Schedule B, Part I, must be completed line by line, including the "Totals" line.

Report only foreign taxes paid or accrued and deemed paid with respect to the type of income for which Form 1118 is being completed.

**Column 1.**—If you claim a credit for taxes accrued, show both the date accrued and the date paid (if paid). (See General Instruction E.)

**Column 2.**—Enter the type of tax (income, war profits, or excess profits).

**Column 4.**—Enter foreign taxes paid or accrued on the line for the country or U.S. possession imposing the tax. Report all amounts in U.S. dollars. If amounts were converted from foreign currency, attach a schedule showing in detail how the conversion rates were determined. See General Instruction G for proof of credits required.

Include in column 4(g) tax withheld at source on income other than dividends, interest, rents, royalties, and license fees, and all other foreign taxes paid or accrued. Do not include taxes deemed to have been paid, which are reported in column 5.

**Column 5.**—Enter the tax deemed paid to each foreign country or U.S. possession from column 11, Schedule C.

## Part III.—Summary of Credits from Separate Forms 1118

Complete Schedule B, Part III on only one Form 1118. Enter the credits from Schedule B, Part II, line 15 of the separate Forms 1118 on lines 1 through 5, Part III.

## Schedule C

### Computation of Taxes Deemed to Have Been Paid by Domestic Corporation Filing This Return

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

Computations under section 902(a) and 960(a) for a first-tier foreign corporation, even though for the same year, must be made on separate lines. Further, separate lines must be used for computations under sections 902(a) and 960(a) with respect to the foreign income taxes deemed paid by a first-tier foreign corporation under section 902(b)(1). (See General Instruction H(3).)

**Column 3.**—If computation is for a second-tier or third-tier foreign corporation under section 960(a), also indicate (in parentheses) the country of incorporation of the first-tier foreign corporation of such second-tier or third-tier foreign corporation.

**Column 5.**—The gains, profits, and income are 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 8) were paid.

**Column 6.**—See General Instruction G for proof of credit required, and General Instruction I(3) for reduction of foreign taxes for failure to furnish information required under section 6038.

See General Instruction H(3) for exclusions from the earnings and profits of a first-tier foreign corporation for purposes of applying sections 902(a) and 960(a) with respect to the foreign income taxes deemed paid by such first-tier foreign corporation under section 902(b)(1).

**Column 8.**—Enter the amount of dividends: (1) paid or constructively distributed by the related foreign corporation; and (2) paid or deemed distributed by the DISC or former DISC to the domestic corporation.

See General Instruction H(3) for certain distributions made by a first-tier foreign corporation to the domestic corporation which are not treated as dividends for purposes of applying section 902(a) with respect to the foreign income taxes deemed paid by such first-tier foreign corporation under section 902(b)(1).

For purposes of section 902, IRS may determine from which year's accumulated profits the dividends were paid. In making the determination, IRS will, unless it is otherwise established to its satisfaction, treat any dividends which are paid in the first 60 days of any tax year as having been paid from the accumulated profits of the preceding tax year or years, and will treat dividends which are paid after the first 60 days of any tax year as having been paid from the most recently accumulated profits.

## **Schedule D**

### **Computation of Tax Deemed to Have Been Paid by First-tier Foreign Corporations**

**Column 1.**—Enter the name of the second-tier foreign corporation and its related first-tier foreign corporations.

**Column 2.**—If dividends are from accumulated profits 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 5.**—Same as Schedule C, column 6.

**Column 7.**—Enter the amount of dividends paid by the second-tier foreign corporation to the first-tier foreign corporation to which section 902(b)(1) applies.

**Column 10.**—Carry the amount of tax deemed to have been paid to Schedule C, column 9 and enter on the line for the related first-tier foreign corporation.

## **Schedule E**

### **Computation of Tax Deemed to Have Been Paid by Second-tier Foreign Corporations**

**Column 1.**—Enter the name of the third-tier foreign corporation and its related second-tier foreign corporation.

**Column 2.**—Same as Schedule D.

**Column 5.**—Same as Schedule C, column 6.

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

**Column 10.**—Carry the amount of tax deemed to have been paid to Schedule D, column 8 and enter on the line for the appropriate year of the related second-tier foreign corporation.

## **Schedule F**

### **Computation of Reduction of Oil and Gas Extraction Taxes**

Attach Schedule F (Form 1118) if you derived any foreign oil and gas extraction income during the tax year.