



# Instructions for Form 1118

(Rev. December 2013)

## Foreign Tax Credit—Corporations

Section references are to the Internal Revenue Code unless otherwise noted.

### Future Developments

For the latest information about developments related to Form 1118 and its instructions, such as legislation enacted after they were published, go to [www.irs.gov/form1118](http://www.irs.gov/form1118).

### What's New for 2013

- **Identifying numbers.** On pages 3 through 8 of the form, two columns have been added to Schedules C, D, and E. New columns 1b request the employer identification number of the distributing foreign corporations and new columns 1c request the reference ID number of these corporations. See *Reference ID numbers*, later for information on what to enter in these columns.
- **Schedule C, Part I.** On page 3 of the form, columns 11 and 12 have been added to Schedule C, Part I, to account for taxes limited by section 960(c). Previously, this limitation was entered on the "Other reductions of taxes" line of Schedule G.
- **Schedule G, Part I.** On page 9 of the form, new line E has been added to Schedule G, Part I, to account for taxes suspended under section 909. Previously, this limitation was entered on the "Other reductions of taxes" line of Schedule G.

### General Instructions

#### Purpose of Form

Use Form 1118 to compute a corporation's foreign tax credit for certain taxes paid or accrued to foreign countries or U.S. possessions. See *Taxes Eligible for a Credit*, later.

#### Who Must File

Any corporation that elects the benefits of the foreign tax credit under section 901 must complete and attach Form 1118 to its income tax return.

#### When to Make the Election

The election to claim the foreign tax credit (or a deduction in lieu of a credit) for any tax year may be made or changed at any time before the end of a special 10-year period described in section 6511(d)(3) (or section 6511(c) if the period is extended by agreement).

### Computer-Generated Form 1118

The corporation may submit a computer-generated Form 1118 and schedules if they conform to the IRS version. However, if a software program is used, it must be approved by the IRS for use in filing substitute forms. This ensures the proper placement of each item appearing on the IRS version. For more information, see Pub. 1167, General Rules and Specifications for Substitute Forms and Schedules.

### How To Complete Form 1118

- Important.** Complete a separate Schedule A; Schedule B, Parts I & II; Schedules C through G; Schedule I; and Schedule K for each applicable separate category of income. See *Categories of Income* later. Complete Schedule B, Part III; Schedule H; and Schedule J only once.
- Use **Schedule A** to compute the corporation's income or loss before adjustments for each applicable category of income.
  - Use **Schedule B** to determine the total foreign tax credit after certain limitations.
  - Use **Schedule C** to compute taxes deemed paid by the domestic corporation filing the return.
  - Use **Schedules D and E** to compute taxes deemed paid by lower-tier foreign corporations.
  - Use **Schedule F** to report gross income and definitely allocable deductions from foreign branches.
  - Use **Schedule G** to report required reductions of tax paid, accrued, or deemed paid.
  - Use **Schedule H** to apportion deductions that cannot be definitely allocated to some item or class of income.
  - Use **Schedule I** (a separate schedule) to compute reductions of taxes paid, accrued, or deemed paid on foreign oil and gas extraction income.
  - Use **Schedule J** (a separate schedule) to compute adjustments to separate limitation income or losses in determining the numerators of limitation fractions, year-end recharacterization balances, and overall foreign and domestic loss account balances.
  - Use **Schedule K** (a separate schedule) to reconcile the corporation's prior year foreign tax carryover with its current year foreign tax carryover.

### Categories of Income

Compute a separate foreign tax credit for each applicable separate category described below.

#### Passive Category Income

Passive category income includes passive income and specified passive category income.

**Passive income.** Generally, passive income is:

- Any income received or accrued that would be foreign personal holding company income (defined in section 954(c)) if the corporation were a controlled foreign corporation (CFC) (defined in section 957). This includes any gain on the sale or exchange of stock that is more than the amount treated as a dividend under section 1248. However, in determining if any income would be foreign personal holding company income, the rules of section 864(d)(6) will apply only for income of a CFC.
- Any amount includible in gross income under section 1293 (which relates to certain passive foreign investment companies).

Passive income does **not** include:

- Any financial services income that is general category income (see *General Category Income*, later),
- Any export financing interest unless it is also related person factoring income (see section 904(d)(2)(G) and Regulations section 1.904-4(h)(3)),
- Any high-taxed income (see *General Category Income* and the instructions for Schedule A, later), or
- Any active rents or royalties. See Regulations section 1.904-4(b)(2)(iii) for definitions and exceptions.

**Note.** Certain income received from a CFC and certain dividends from a 10/50 corporation that would otherwise be passive income may be assigned to another separate category under the look-through rules. See *Look-Through Rules*, later.

#### Specified passive category income.

This term includes:

- Dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as foreign source income, and
- Distributions from a former FSC out of earnings and profits attributable to foreign trade income or interest or carrying charges (as defined in section 927(d)(1),

before its repeal) derived from a transaction which results in foreign trade income (as defined in section 932(b), before its repeal).

## Section 901(j) Income

No credit is allowed for foreign taxes imposed by and paid or accrued to certain sanctioned countries. However, income derived from **each** such country is subject to a separate foreign tax credit limitation. Therefore, the corporation must use a separate Form 1118 for income derived from each such country. On each Form 1118, check the box for section 901(j) income at the top of page 1 and identify the applicable country in the space provided.

Sanctioned countries are those designated by the Secretary of State as countries that repeatedly provide support for acts of international terrorism, countries with which the United States does not have diplomatic relations, or countries whose governments are not recognized by the United States. As of the date these instructions were revised, section 901(j) applied to income derived from Cuba, Iran, North Korea, Sudan, and Syria. For more information, see section 901(j).

**Note.** The President of the United States has the authority to waive the application of section 901(j) with respect to a foreign country if it is (a) in the national interest of the United States and will expand trade and investment opportunities for U.S. companies in such foreign country and (b) the President reports to the Congress, not less than 30 days before the waiver is granted, the intention to grant such a waiver and the reason for such waiver.

**Note.** Effective December 10, 2004, the President waived the application of section 901(j) with respect to Libya.

If the corporation paid taxes to a country that ceased to be a sanctioned country during the tax year, see Rev. Rul. 92-62, 1992-2 C.B. 193, for details on how to figure the foreign tax credit for the period that begins after the end of the sanctioned period.

## Income Re-sourced by Treaty

If a sourcing rule in an applicable income tax treaty treats any U.S. source income as foreign source, and the corporation elects to apply the treaty, the income will be treated as foreign source.

**Important.** The corporation must compute a separate foreign tax credit limitation for any such income for which it claims benefits under a treaty, using a separate Form 1118 for each amount of re-sourced income from a treaty country. On each Form 1118, check the box for

income re-sourced by treaty at the top of page 1 and identify the applicable country in the space provided. See sections 865(h), 904(d)(6), and 904(h)(10) and the regulations under those sections (including Regulations section 1.904-5(m)(7)) for any grouping rules and exceptions.

## General Category Income

This category includes all income not described above. This includes high-taxed income that would otherwise be passive category income. Usually, income is high-taxed if the total foreign income taxes paid, accrued, or deemed paid by the corporation for that income exceed the highest rate of tax specified in section 11 (and with reference to section 15, if applicable), multiplied by the amount of such income (including the amount treated as a dividend under section 78). For more information, see Regulations section 1.904-4(c). Also see the instructions for Schedule A, later, for additional reporting requirements.

This category also includes financial services income (defined below) if the corporation is a member of a financial services group (as defined in section 904(d)(2)(C)(ii)) or is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business.

**Financial services income.** Financial services income is income received or accrued by a member of a financial services group or any corporation predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, if the income is:

- Described in section 904(d)(2)(D)(ii),
- Passive income (determined without regard to section 904(d)(2)(B)(iii)(II)), or
- Incidental income described in Regulations section 1.904-4(e)(4).

## Special Rules

### Source Rules for Income

Determine income or (loss) for each separate category on Schedule A using the general source rules of sections 861 through 865 and related regulations; the special source rules of section 904(h) described below; and any applicable source rules contained in any applicable tax treaties.

**Special source rules of section 904(h).** Usually, the following income from a U.S.-owned foreign corporation, otherwise treated as foreign source income, must be treated as U.S. source income under section 904(h):

- Any subpart F income, foreign personal holding company income, or income from a qualified electing fund that a U.S. shareholder is required to include in its

gross income, if such amount is attributable to the U.S.-owned foreign corporation's U.S. source income;

- Interest that is properly allocable to the U.S.-owned foreign corporation's U.S. source income; and
- Dividends equal to the U.S. source ratio (defined in section 904(h)(4)(B)).

The rules regarding interest and dividends described above do not apply to a U.S.-owned foreign corporation if less than 10% of its E&P for the tax year is from U.S. sources.

## Amounts That Do Not Constitute Income Under U.S. Tax Principles

For tax years beginning after December 31, 2006, creditable foreign taxes that are imposed on amounts that do not constitute income under U.S. tax principles are treated as imposed on general category income. See section 904(d)(2)(H).

## Look-Through Rules

**CFCs.** Generally, dividends, interest, rents, and royalties received or accrued by the taxpayer are passive category income. However, if these items are received or accrued by a 10% U.S. shareholder from a CFC, they may be assigned to other separate categories under the look-through rules of section 904(d)(3). This includes:

- Interest, rents, and royalties based on the amount allocable to E&P of the CFC in a separate category and
- Dividends paid out of the E&P of a CFC in proportion to the ratio of the CFC's E&P in a separate category to its total E&P. Dividends include any amount included in gross income under section 951(a)(1)(B).

Look-through rules also apply to subpart F inclusions under section 951(a)(1)(A) to the extent attributable to E&P of the CFC in a separate category.

For more information and examples, see section 904(d)(3) and Regulations section 1.904-5.

**10/50 corporations.** Generally, dividends received or accrued by the taxpayer are passive category income. However, dividends received or accrued from a 10/50 corporation may be assigned to other separate categories under the look-through rules of section 904(d)(4). A 10/50 corporation is any foreign corporation in which the taxpayer (domestic corporation) meets the stock ownership requirements of section 902. See Regulations section 1.904-5(c)(4)(iii).

## Certain amounts paid by a U.S. corporation to a related corporation.

Look-through rules also apply to foreign source interest, rents, and royalties paid by a U.S. corporation to a related

corporation. See Regulations section 1.904-5(g).

## Other Rules

**Certain transfers of intangible property.** See section 367(d)(2)(C) for a rule that clarifies the treatment of certain transfers of intangible property.

## Reporting Foreign Tax Information From Partnerships

If you received a Schedule K-1 from a partnership that includes foreign tax information, use the rules below to report that information on Form 1118.

### Gross income sourced at partner level.

This includes income from the sale of most personal property other than inventory, depreciable property, and certain intangible property sourced under section 865. This gross income will generally be U.S.-source and therefore will not be reported on Form 1118.

The remaining lines of the foreign tax section of the Schedule K-1 are reported on Form 1118 as follows:

**Foreign gross income sourced at partner level.** Report on Schedule A.

**Deductions allocated and apportioned at partner level and partnership level.** Report on Schedule A or Schedule H.

**Total foreign taxes paid or accrued.** Report on Schedule B.

**Reduction in taxes available for credit.** Report on Schedule G.

## Capital Gains

Foreign source taxable income (or loss) before adjustments in all separate categories in the aggregate should include gain from the sale or exchange of capital assets only up to the amount of foreign source capital gain net income (which is the smaller of capital gain net income from sources outside the United States or capital gain net income). Therefore, if the corporation has capital gain net income from sources outside the United States in excess of the capital gain net income reported on its tax return, enter a pro rata portion of the net U.S. source capital loss as a negative number on Schedule A, column 9(d) for each separate category with capital gain net income from sources outside the United States. To figure the pro rata portion of the net U.S. source capital loss attributable to a separate category, multiply the net U.S. source capital loss by the amount of capital gain net income from sources outside the United States in the separate category divided by the aggregate amount of capital gain net income from sources outside the United States in all separate categories with capital gain net income from sources outside the United States.

See section 904(b)(2)(B) for special rules regarding adjustments to account for capital gain rate differentials (as defined in section 904(b)(3)(D)) for any tax year. At the time these instructions went to print, there was no capital gain rate differential for corporations.

## Credit Limitations

### Taxes Eligible for a Credit

**Domestic corporations.** Generally, a domestic corporation may claim a foreign tax credit (subject to the limitation of section 904) for the following taxes:

- Income, war profits, and excess profits taxes (defined in Regulations section 1.901-2(a)) paid or accrued during the tax year to any foreign country or U.S. possession;
- Taxes deemed paid under sections 902 and 960; and
- Taxes paid in lieu of income taxes as described in section 903 and Regulations section 1.903-1.

Some foreign taxes that are otherwise eligible for the foreign tax credit must be reduced. These reductions are reported on Schedule G.

**Note.** A corporation may not claim a foreign tax credit for foreign taxes paid to a foreign country that the corporation does not legally owe, including amounts eligible for refund by the foreign country. If the corporation does not exercise its available remedies to reduce the amount of foreign tax to what it legally owes, a credit is not allowed for the excess amount.

**Foreign corporations.** Foreign corporations are allowed (under section 906) a foreign tax credit for income, war profits, and excess profits taxes paid or accrued (or deemed paid under section 902) to any foreign country or U.S. possession for income effectively connected with the conduct of a trade or business within the United States. The credit is not applicable, however, if a foreign country or U.S. possession imposes the tax 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 may not be taken against any tax imposed on income not effectively connected with a U.S. business.

In computing the foreign tax credit limitation, the foreign corporation's taxable income includes only the taxable income that is effectively connected with the conduct of a trade or business within the United States.

A foreign corporation claiming a foreign tax credit will be treated as a domestic

corporation in computing tax deemed paid (section 902(a)) and dividend gross-up (section 78).

### Definition of foreign corporation for purposes of the deemed paid credit.

In computing the deemed paid credit on Schedules C, D, and E, the term "foreign corporation" includes:

- A DISC or former DISC, but only for dividends from the DISC or former DISC that are treated as income from sources outside the United States and
- A contiguous country life insurance branch that has made an election to be treated as a foreign corporation under section 814(g).

## Credit or Deduction

A corporation may choose to take either a credit or a deduction for eligible foreign taxes paid or accrued. The choice is made annually. Generally, if a corporation elects the benefits of the foreign tax credit for any tax year, no portion of the foreign taxes will be allowed as a deduction in that year or any subsequent tax year.

**Exceptions.** However, a corporation that elects the credit for eligible foreign taxes may be allowed a deduction for certain taxes for which a credit was not allowed. These include:

- Taxes for which the credit was denied because of the boycott provisions of section 908.
- Certain taxes on the purchase or sale of oil or gas (section 901(f)).
- Certain taxes used to provide subsidies (section 901(i)).
- Taxes paid to certain foreign countries for which a credit was denied under section 901(j).
- Certain taxes paid on dividends if the minimum holding period is not met with respect to the underlying stock, or if the corporation is obligated to make related payments with respect to positions in similar or related property (section 901(k)).
- Certain taxes paid on gain and income other than dividends if the minimum holding period is not met with respect to the underlying property, or if the corporation is obligated to make related payments with respect to positions in similar or related property (see section 901(l)).
- In the case of a covered asset acquisition (as defined in section 901(m)(2)), the disqualified portion of any tax determined with respect to the income or gain attributable to the relevant foreign assets (section 901(m)). **Note.** This rule generally applies to covered asset acquisitions after December 31, 2010.

## No Credit or Deduction

No foreign tax credit (or deduction) is allowed for certain taxes including:

- Taxes on mineral income that were reduced under section 901(e).
- Certain taxes paid on distributions from possessions corporations (section 901(g)).
- Taxes on combined foreign oil and gas income that were reduced under section 907(a).
- Taxes attributable to income excluded under section 814(a) (relating to contiguous country branches of domestic life insurance companies).
- Taxes paid or accrued to a foreign country or U.S. possession with respect to income excluded from gross income on Form 8873, Extraterritorial Income Exclusion. However, see section 943(d) for an exception for certain withholding taxes.

### Carryback and Carryforward of Excess Foreign Taxes

If the allowable foreign taxes paid, accrued, or deemed paid in a tax year in a separate category exceed the foreign tax credit limitation for the tax year for that separate category, the excess may be:

- Carried back 1 year to offset taxes imposed in the same category.
- Carried forward 10 years to offset taxes imposed in the same category (5 years for excess foreign taxes which may be carried only to tax years ending before October 23, 2004).

The excess is applied first to the earliest of the years to which it may be carried, then to the next earliest year, etc. The corporation may not carry a credit to a tax year for which it claimed a deduction, rather than a credit, for foreign taxes paid or accrued. Furthermore, the corporation must reduce the amount of any carryback or carryforward by the amount it would have used if it had chosen to claim a credit rather than a deduction in that tax year. See section 904(c) and Regulations section 1.904-2 for more details.

**How to claim the excess credit.** If the corporation is carrying back the excess credit to an earlier year, file an amended tax return with a revised Form 1118 and schedules (including a revised Schedule K (Form 1118)).

Special rules apply to:

- The carryback and carryover of foreign taxes paid or accrued on combined foreign oil and gas income or related taxes (see section 907(f)) and
- An excess foreign tax credit for which an excess limitation account was established under section 960(b)(2).

**Special rules for carryforwards of pre-2007 unused foreign taxes.** The foreign taxes carried forward generally are allocated to the post-2006 separate categories to which those taxes would have been allocated if the taxes were paid

or accrued in a tax year beginning after 2006. Alternatively, the corporation can allocate unused foreign taxes in its pre-2007 passive income category to the post-2006 separate category for passive category income, and can allocate all other unused foreign taxes in pre-2007 separate categories that were eliminated in 2007 to the post-2006 separate category for general category income.

### Treaty-Based Return Positions

Corporations that adopt a return position that any U.S. treaty overrides or modifies any provision of the Internal Revenue Code, and causes (or potentially causes) a reduction of any tax incurred at any time, generally must disclose this position. Complete Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or Section 7701(b), and attach it to Form 1118. See section 6114 and Regulations section 301.6114-1 for details.

Failure to make such a report may result in a \$10,000 penalty.

### Proof of Credits

Form 1118 must be carefully filled in with all the information called for and with the calculations of credits indicated.

**Important.** Documentation (that is, receipts of payments or a foreign tax return for accrued taxes) is not required to be attached to Form 1118. However, proof **must** be presented upon request by the IRS to substantiate the credit. See Regulations section 1.905-2.

If the corporation claims a foreign tax credit for tax accrued but not paid, the IRS may require a bond to be furnished on Form 1117, Income Tax Surety Bond, before the credit is allowed. See Regulations section 1.905-2(c).

### Foreign Tax Credit Redeterminations

The corporation's foreign tax credit and U.S. tax liability generally must be redetermined if:

- Accrued foreign taxes when paid differ from the amounts claimed as credits;
- Accrued foreign taxes are not paid within 2 years after the close of the tax year to which they relate; or
- Any foreign tax paid is fully or partially refunded.

Except as provided in Temporary Regulations section 1.905-3T(d)(3), a redetermination of U.S. tax liability is not required to account for the effect of a redetermination of foreign tax paid or accrued by a foreign corporation on the amount of foreign taxes deemed paid

under section 902 or 960. Instead, the foreign corporation's pools of E&P and foreign taxes are adjusted in the year of the foreign tax redetermination.

### Reporting Requirements

If the corporation must redetermine its U.S. tax liability, the corporation must:

- File an amended return and Form 1118 with the Service Center where it filed the tax return on which it claimed the affected foreign tax credit and
- Provide identifying information such as the corporation's name, address, employer identification number (EIN), and the tax year or years that are affected by the redetermination.

**Additional information required.** If the redetermination was because of one of the following, the corporation must provide the additional information as indicated.

• **Refund of foreign taxes paid—**

1. The date or dates on which the foreign taxes were accrued, paid, and refunded;
2. The amount of foreign taxes accrued, paid, and refunded on each date (in foreign currency); and
3. The exchange rates used to translate such amounts.

• **Foreign taxes that when paid differ from the accrued amounts claimed as credits for a year beginning before 1998—**

1. The date on which the foreign taxes were accrued;
2. The dates on which the foreign taxes were paid;
3. The exchange rate for each date the foreign taxes were accrued and paid; and
4. The amount of foreign taxes accrued or paid on each such date (in foreign currency).

• **Foreign taxes that when paid differ from accrued amounts claimed as credits for a tax year beginning after 1997 because the corporation paid more or less foreign tax than was originally accrued or failed to pay accrued taxes within 2 years—**

1. The date on which the foreign taxes were accrued;
2. The dates on which the foreign taxes were paid;
3. The average exchange rate for the year for which the foreign taxes were accrued;
4. For taxes paid more than 2 years after the year to which they relate, the exchange rate at the time of payment; and
5. The amount of tax accrued or paid for each such date, and the amount of

accrued tax that was not paid within 2 years (in foreign currency).

• **Foreign taxes deemed paid under section 902 or 960**—If the corporation is required to make a redetermination under Temporary Regulations section 1.905-3T(d)(3), include the following basic information as an attachment to the tax return for the year for which the redetermination applies:

1. The dates and amounts of any dividend distributions or other inclusions from E&P for the affected year or years;
2. The amount of E&P from which such dividends were paid for the affected year or years;
3. The current balances of the pools of E&P and foreign taxes before and after the foreign tax adjustment; and
4. The information described above for foreign taxes paid or accrued, as applicable.

If foreign taxes deemed paid under sections 902 or 960 are adjusted and the corporation is not required to redetermine its U.S. tax liability, adjust the appropriate pools of foreign taxes and E&P using the rules outlined in Temporary Regulations sections 1.905-3T(d)(2)(ii) and 1.905-4T(b)(2).

Amended returns for all years affected by foreign tax redeterminations that result in U.S. tax deficiencies and that occurred in the three tax years immediately preceding the corporation's first tax year beginning on or after November 7, 2007 (and tax years of foreign subsidiaries ending with or within such tax years of their domestic corporate shareholders), are due no later than the due date (with extensions) of the corporation's return for its second tax year beginning on or after November 7, 2007. Amended returns for all years affected by foreign tax redeterminations that result in U.S. tax deficiencies and that occur in tax years beginning after November 7, 2007 (and tax years of foreign subsidiaries ending with or within such tax years of their domestic corporate shareholders), are due no later than the due date (with extensions) of the corporation's return for its tax year in which the foreign tax redetermination occurs. For special rules relating to corporations under the jurisdiction of the Large Business & International Division, see Temporary Regulations sections 1.905-4T(b)(3) and 1.905-4T(f)(2)(iii).

## Interest and Penalties

In most cases, interest is computed on the deficiency or overpayment that resulted from the foreign tax adjustment (sections 6601 and 6611 and the related regulations). See Temporary Regulations

section 1.905-4T(e) for additional information.

If the corporation does not comply with the requirements discussed above within the time for filing specified, the penalty provisions of section 6689 (and the related regulations) will apply.

## Specific Instructions

Report all amounts in U.S. dollars unless otherwise specified. If it is necessary to convert from a foreign currency, attach a statement explaining how the conversion rate was determined.

### Separate Category of Income Boxes

The corporation must complete a separate Form 1118 for each applicable category of income. See *Categories of Income*, earlier.

## Schedule A

Report gross income or (loss) from sources outside the United States for the applicable separate category in columns 2 through 7. Gross income equals gross receipts reduced by cost of goods sold. Report the applicable deductions to this gross income in columns 9 and 10. Report any net operating loss carryover in column 11. Be sure to include in all columns the gross income and deductions that pertain to foreign branches.

**Section 863(b) gross income and deductions.** Aggregate all section 863(b) gross income and deductions and report the totals on a single line. It may be necessary to enter amounts in multiple columns on that single line, depending upon the nature of the section 863(b) gross income and deductions. For example, enter "863(b)" in column 1 and enter (as a positive number) all section 863(b) gross income (in columns 2 through 8) and all section 863(b) deductions (in columns 9a through 12). Also enter the net amount in column 13. Note that the totals are being reported on a single line because it is not necessary to report section 863(b) gross income and deductions on a per-country basis.

**RIC pass-through amounts.** Aggregate all income passed through from regulated investment companies (RICs) and report the total on a single line. Enter "RIC" in column 1 and report the total in column 13. Note that the totals are being reported on a single line because it is not necessary to report the RIC pass-through amounts on a per-country basis.

**Net operating losses.** Report any net operating loss carryover on a single line. Enter "NOL" in column 1 and report the

total in column 11. Note that the totals are being reported on a single line because it is not necessary to report the NOL on a per-country basis.

**Reclassifications of high-taxed income.** Aggregate all reclassifications of high-taxed income and report the total on a single line. With respect to passive category income, for items of income that have been included on Schedule A and that must be reclassified under the rules of Regulations section 1.904-4(c), enter "HTKO" in column 1 and enter (as a negative number) in column 13 the net amount of income that is being reclassified from passive category income. With respect to general category income, enter "HTKO" in column 1 and enter (as a positive number) in column 13 the net amount of income that is being reclassified to general category income. Note that the reclassifications are being reported on a single line because it is not necessary to report them on a per-country basis. Also note that tax reclassifications are needed on Schedule B. See those instructions for more information. Also see *General Category Income*, earlier, for general additional information about high-taxed income.

**Column 1.** Enter the two-letter codes (from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes)) of all foreign countries and U.S. possessions within which income is sourced and/or to which taxes were paid, accrued, or deemed paid.

For section 863(b) income, enter "863(b)" instead of a two-letter code.

For income passed through from a RIC, enter "RIC" instead of a two-letter code.

For a net operating loss, enter "NOL" instead of a two-letter code.

For income adjustments for high-taxed income, enter "HTKO" instead of a two-letter code.

 *When you enter a country code in Schedule A, column 1, the information entered on the corresponding line of Schedule B, Part I, must pertain to that country code.*

**Column 2(a).** If the corporation is a U.S. shareholder in a CFC, report all income deemed received under section 951(a)(1)(A) (before gross-up). See section 904(d)(3) and *Look-Through Rules*, earlier, for more information. If the corporation is a U.S. shareholder in a passive foreign investment company (PFIC) and receives distributions from stock in that PFIC, report all income deemed received (before gross-up) under section 1291.

**Column 3(a).** Report all other dividends (before gross-up) not included in column 2(a) from sources outside the United States for the applicable separate

category. Other dividends include amounts included in gross income under section 951(a)(1)(B).

**Note.** All dividends from a domestic corporation are of U.S. source, including dividends from a domestic corporation which has 80% or more of its gross income from sources outside the United States.

**Columns 2(b) and 3(b).** Include taxes deemed paid by a domestic corporation under section 902 or section 960 on distributions by a foreign corporation in income as dividend gross-up. See Regulations section 1.960-3(b) for exceptions.

**Column 4.** Enter all interest received from foreign sources. See section 861(c) for the treatment of interest from a domestic corporation that meets the foreign business requirement.

**Column 6.** Include gross income, including compensation, commissions, fees, etc., for technical, managerial, engineering, construction, scientific, or similar services outside the United States. Be sure to include gross income from services performed through a foreign branch.

**Column 7.** Include all other gross income from sources outside the United States for the applicable separate category, including all other gross income of foreign branches and pass-through entities and any exchange gain or loss recognized under sections 986(c) or 987(3) on a distribution or remittance of previously taxed amounts. Attach a schedule identifying the gross income by type and by the foreign country or U.S. possession from which it was sourced.

**Column 9(d).** Include all other deductions definitely allocable to income from sources outside the United States (dividends, interest, etc.) for the applicable separate category. Include deductions allocable to income of foreign branches.

Include any reduction of foreign source capital gain net income. If foreign source capital gain net income from all separate categories is more than the capital gain net income reported on the corporation's tax return, enter a pro rata portion of the excess as a negative number in each separate category. See *Capital Gains*, earlier.

**Column 10.** Enter only the apportioned share from Schedule H, Part II, column (d) that relates to gross income reported in columns 2 through 7.

**Note.** If the corporation qualified as a financial services entity because it treated certain amounts as active financing income that are not listed in Regulations sections 1.904-4(e)(2)(i)(A) through (X),

but that are described as similar items in Regulations section 1.904-4(e)(2)(i)(Y), attach a statement to Form 1118 showing the types and amounts of the similar items.

**Column 11.** Enter the corporation's net operating loss as defined in section 172 that is attributable to foreign source income in the separate limitation category. If the net operating loss is part of an overall foreign loss, see Temporary Regulations section 1.904(g)-3T for allocation rules that apply in determining the amount to enter in column 11.

It is not necessary to report the NOL adjustment on a per-country basis. See *Net Operating Losses*, earlier.

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## Schedule B

### Part I—Foreign Taxes Paid, Accrued, and Deemed Paid

Report only foreign taxes paid, accrued, or deemed paid for the separate category for which this Form 1118 is being completed. Report all amounts in U.S. dollars. If the corporation must convert from foreign currency, attach a schedule showing the amounts in foreign currency and the exchange rate used.

For corporations claiming the credit on the accrual basis, the exchange rate for translating foreign taxes into U.S. dollars will generally be an average exchange rate for the tax year to which the taxes relate. However, the exchange rate on the date of payment must be used if the foreign taxes (a) are paid more than 2 years after the close of the tax year to which they relate or (b) are paid in a tax year prior to which they relate. In addition, for tax years beginning after December 31, 2004, taxpayers may elect to use the exchange rate on the date of payment. Taxpayers may elect to use the payment date exchange rates for all creditable foreign income taxes or only those taxes that are attributable to qualified business units with U.S. dollar functional currencies. The election is made by attaching a statement to a timely-filed (including extensions) Form 1118 that indicates the corporation is making the election under section 986(a)(1)(D). Once made, the election applies for all subsequent tax years and is revocable only with the consent of the IRS. See section 986(a).



*The information entered on each line of Schedule B, Part I must pertain to the country code specified on the corresponding line of Schedule A, column 1.*

**Column 1.** Claim the foreign tax credit for the tax year in which the taxes were paid or accrued, depending on the method of accounting used.

**Note.** For any given tax year, the corporation can use the cash method or the accrual method, but not both. If a credit for taxes accrued is claimed, show both the date accrued and the date paid (if paid).

If the cash method of accounting is used, an election under section 905(a) may be made to claim the credit based on accrued taxes. If this election is made, figure the foreign tax credit for all subsequent tax years on the same basis. Also, the credits are subject to the redetermination provisions of section 905(c). See *Foreign Tax Credit Redeterminations*, earlier, for details.

**Column 2(d).** Include foreign taxes paid or accrued on foreign branch taxable income to which the rules of section 863(b) apply.

**Note.** Do not include these overlapping amounts in column 2(e).

### Part II—Separate Foreign Tax Credit

**Line 1b.** If the corporation had a foreign tax credit splitting event in a prior tax year that resulted in a suspension of foreign taxes under section 909, enter the amount of those taxes attributable to related income taken into account in the current tax year. The amount of taxes suspended in a prior tax year should have appeared on Schedule G, line E on your Form 1118 for that prior tax year. See the regulations under section 909 for rules for determining when related income is taken into account and the amount of previously-suspended taxes that are attributable to that related income.

**Line 4.** If the corporation is reclassifying high-taxed income from passive category income to general category income, enter the related tax adjustment on line 4. Indicate whether adjustment is positive or (negative). See *General Category Income*, earlier, for additional information.

**Line 5.** Enter the total amount of foreign taxes carried forward or back to the current year. The amount of foreign taxes carried forward to the current tax year is the amount from Schedule K (Form 1118), line 3, column (xiv) plus the amount from Schedule I, Part III, line 3. Attach Schedule I (Form 1118) and Schedule K (Form 1118) to Form 1118.

**Line 7.** If the corporation has a current year overall domestic loss or recapture of an overall domestic loss account, or, in any of its separate categories, a current year separate limitation loss, an overall foreign loss, recapture of an overall foreign loss, or current year separate limitation income in a category in which it has a beginning balance of income that must be recharacterized, adjustments

must be made. See the separate instructions for Schedule J to determine if that schedule must be filed.

**Line 8b.** Enter taxable income that should not be taken into account in computing the foreign tax credit limitation.

**Line 9.** Divide line 7 by line 8c to determine the limitation fraction. Enter the fraction on line 9 as a decimal with the same number of places as the number of digits to the left of the decimal in adjusted taxable income on line 8c. For example, if adjusted taxable income on line 8c is \$100,000, compute the limitation fraction to 6 decimal places.

**Line 11.** The limitation may be increased under section 960(b) for any tax year that the corporation receives a distribution of previously taxed E&P. See section 960(b). If an increase in the limit under section 960(b)(5) exceeds the corporation's U.S. income tax liability, the excess is deemed an overpayment and can be claimed on the corporation's income tax return as a refundable credit (Form 1120, Schedule J, Part II, line 19d, or the corresponding line of other corporate income tax returns).

### Part III—Summary of Separate Credits

Complete Part III only once. Enter on lines 1 through 3 the separate foreign tax credits from Part II, line 12, for each applicable separate category.

**Note.** Complete Part III only on the Form 1118 with the largest amount entered on Part II, line 12.

**Line 5.** If the corporation participates in or cooperates with an international boycott, the foreign tax credit may be reduced. Complete Form 5713, International Boycott Report. If the corporation chooses to apply the international boycott factor to calculate the reduction in the credit, enter the amount from line 2a(3) of Schedule C (Form 5713) on line 5.

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## Schedules C, D, and E

If the corporation is a partner in a partnership, for taxes of foreign corporations for tax years beginning after October 22, 2004, stock owned directly or indirectly, by or for a partnership shall be considered as being owned proportionately by its partners. See section 902(c)(7).

### Identifying Numbers

On Schedules C, D, and E, columns 1b request an employer identification number (EIN) and columns 1c request a reference ID number. A reference ID number is required in columns 1c only in cases where no EIN was entered for the foreign corporation in column 1b. However, filers

are permitted to enter both an EIN in column 1b and a reference ID number in column 1c.

**Reference ID numbers.** A "reference ID number" is a number established by or on behalf of the U.S. corporation filing Form 1118. These numbers are used to uniquely identify foreign corporations on Schedules C, D, and E, in order to keep track of those corporations from tax year to tax year. The reference ID number must meet the requirements set forth below.

**Note.** Because reference ID numbers are established by or on behalf of the U.S. corporation filing Form 1118, there is no need to apply to the IRS to request a reference ID number or for permission to use these numbers.

**Note.** In general, the reference ID number assigned to a foreign corporation on Form 1118 has relevance only on Form 1118 (and on any other form that is attached to or associated with Form 1118) and should not be used with respect to the foreign corporation on other IRS forms.

**Requirements.** The reference ID number must be alphanumeric (defined below) and no special characters or spaces are permitted. The length of a given reference ID number is limited to 50 characters.

For these purposes, the term "alphanumeric" means the entry can be alphabetical, numeric, or any combination of the two.

The same reference ID number must be used consistently from tax year to tax year with respect to a given foreign corporation. If for any reason a reference ID number falls out of use (for example, the foreign corporation no longer exists due to disposition or liquidation), the reference ID number used for that foreign corporation cannot be used again for another foreign corporation for purposes of filing Form 1118.

There are some situations that warrant correlation of a new reference ID number with a previous reference ID number when assigning a new reference ID number to a foreign corporation. For example:

- In the case of a merger or acquisition, a Form 1118 filer must use a reference ID number which correlates the previous reference ID number with the new reference ID number assigned to the foreign corporation.
- In the case of an entity classification election that is made on behalf of a foreign corporation on Form 8832, Regulations section 301.6109-1(b)(2)(v) requires the foreign corporation to have an EIN for this election. For the first year that Form 1118 is filed after an entity classification election is made on behalf of the foreign corporation on Form 8832, the new EIN

must be entered in column 1b and the old reference ID number must be entered in column 1c. In subsequent years, the Form 1118 filer may continue to enter both the EIN and the reference ID number, but must enter at least the EIN in column 1b.

You must correlate the reference ID numbers as follows: New reference ID number [space] Old reference ID number. If there is more than one old reference ID number, you must enter a space between each such number. As indicated above, the length of a given reference ID number is limited to 50 characters and each number must be alphanumeric and no special characters are permitted.

**Note.** This correlation requirement applies only to the first year the new reference ID number is used.

## Schedule C

### Part I—Dividends and Deemed Inclusions From Post-1986 Undistributed Earnings

**Column 1a.** Enter the name of the foreign corporation (or DISC or former DISC) whose earnings were distributed to, or included in income by, the domestic corporation filing the return.

**Columns 1b and 1c.** See *Reference ID numbers*, above.

**Column 2.** Enter the year and month in which the foreign corporation's U.S. tax year ended.

**Example.** When figuring foreign taxes deemed paid in 2013 by a calendar year domestic corporation with respect to dividends and inclusions out of post-1986 undistributed earnings for the foreign corporation's tax year that ended June 30, 2013, enter "201306."

**Column 3.** Enter the applicable two-letter codes from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes).

**Column 4.** Enter the distributing corporation's post-1986 undistributed earnings pool for the separate category for which the schedule is being completed. Generally, this amount is the corporation's E&P (computed in the corporation's functional currency according to sections 964(a) and 986) accumulated in tax years beginning after 1986, determined as of the close of the corporation's tax year without reduction for any earnings distributed or otherwise included in income (that is, under section 304, 367(b), 951(a), 1248, or 1293) during the current tax year.

Post-1986 undistributed earnings are reduced to account for distributions or deemed distributions that reduced E&P and inclusions that resulted in previously taxed amounts described in section 959(c)(1) and (2) or section 1293(c) in prior tax

years beginning after 1986. See Regulations section 1.902-1(a)(9). Also, see section 902(c)(3) and Regulations section 1.902-1(a)(13) for special rules treating earnings accumulated in post-1986 years as pre-1987 accumulated profits when no U.S. shareholder was eligible to claim a section 902 credit with respect to taxes paid by the foreign corporation.

**Column 5.** Enter the opening balance in the distributing corporation's post-1986 foreign income taxes pool for the tax year indicated. This amount is the foreign income taxes paid, accrued, or deemed paid (in U.S. dollars) by the foreign corporation for prior tax years beginning after 1986, reduced by foreign taxes attributable to distributions or deemed inclusions of earnings in prior tax years. See Regulations section 1.902-1(a)(8)(i).

**Column 6(a).** Enter the foreign income taxes paid or accrued by the foreign corporation for the tax year indicated, translated into U.S. dollars using the exchange rate specified in section 986(a).

**Column 6(b).** Enter the foreign income taxes deemed paid (under section 902(b)) by the corporation for the tax year indicated (from Schedule D, Part I, Section A, column 10, and Section B, column 8(b)).

**Column 8(a).** Report the sum (in the foreign corporation's functional currency) of all dividends paid and deemed inclusions out of post-1986 undistributed earnings for the tax year indicated.

**Column 8(b).** Report the column 8(a) amounts, translated into U.S. dollars at the appropriate exchange rates (as defined in section 989(b)). If the foreign corporation's functional currency is the U.S. dollar, **do not** complete column 8(b).

**Column 11.** Enter foreign income taxes deemed paid during the current tax year that exceed the limit (with respect to section 956 inclusions) described in section 960(c).

## Part II—Dividends Paid Out of Pre-1987 Accumulated Profits

Use a separate line for each dividend paid. If a dividend is paid out of the accumulated profits of more than one pre-1987 tax year, figure and show the tax deemed paid on a separate line for each tax year. In applying section 902, the IRS may determine from which tax year's accumulated profits the dividends were paid. See Regulations section 1.902-3(g)(4).

**Important.** The formula for calculating foreign taxes deemed paid under section 902 with respect to dividends paid in a post-1986 year out of pre-1987 accumulated profits requires that all

components (dividends, accumulated profits, and taxes) be maintained in the foreign corporation's functional currency and translated into U.S. dollars at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(10)(ii) and (iii).

**Column 1a.** Enter the name of the first-tier foreign corporation (or DISC or former DISC) that paid a dividend out of pre-1987 profits to the domestic corporation filing the return.

**Columns 1b and 1c.** See *Reference ID numbers*, earlier.

**Column 2.** Enter the year and month in which the foreign corporation's pre-1987 tax year ended.

**Column 3.** Enter the applicable two-letter codes from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes).

**Column 4.** For each line, enter the pre-1987 accumulated profits for the tax year indicated in column 2, computed in functional currency under section 902. See Regulations section 1.902-1(a)(10)(i) and (ii).

**Column 5.** Enter the foreign taxes paid and deemed paid (in functional currency) with respect to the pre-1987 accumulated profits entered in column 4 for the tax year indicated in column 2. See the instructions for Schedule G, later, for information on reduction of foreign taxes for failure to furnish information required under section 6038.

**Column 6(a).** Enter the amount of each dividend paid by the first-tier foreign corporation (or DISC or former DISC) to the domestic corporation (in functional currency) out of the accumulated profits of the pre-1987 tax year indicated in column 2.

**Column 6(b).** Enter the amount from column 6(a) translated into U.S. dollars using the spot exchange rate in effect on the date of distribution. See Regulations sections 1.902-1(a)(10)(ii) and 1.902-3(g)(1).

**Column 8(a).** Multiply column 5 by column 7. Enter this amount in column 8(a) in functional currency.

**Column 8(b).** Enter the amount from column 8(a) translated into U.S. dollars at the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(iii).

## Part III—Deemed Inclusions From Pre-1987 Earnings and Profits

**Important.** The formula for calculating foreign taxes deemed paid under section 960 with respect to deemed inclusions (that is, under section 956 or 1248) in a

post-1986 year out of pre-1987 E&P requires that earnings and profits and foreign taxes be calculated in U.S. dollars under the rules of Regulations section 1.964-1(a) through (e), and then translated into the foreign corporation's functional currency at the exchange rate in effect on the first day of the foreign corporation's first post-1986 tax year. See Notice 88-70, 1988-2 C.B. 369. The deemed inclusion is then translated into U.S. dollars at the appropriate exchange rate specified in section 989(b). Foreign income taxes paid in pre-1987 tax years are translated into U.S. dollars for purposes of section 960 at the exchange rate in effect when the foreign taxes were paid. See Regulations section 1.964-1(d) and Temporary Regulations section 1.905-5T(b)(1).

**Column 1a.** Enter the name of the first- or lower-tier foreign corporation whose earnings were deemed included in the income of the domestic corporation filing the return.

**Columns 1b and 1c.** See *Reference ID numbers*, earlier.

**Column 2.** Enter the year and month in which the corporation's pre-1987 tax year ended. If the deemed inclusion is from the accumulated E&P of more than one tax year, figure and show the tax deemed paid on a separate line for each year.

**Column 3.** Enter the applicable two-letter codes from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes).

**Column 4.** For each line, enter the E&P calculated in U.S. dollars under Regulations sections 1.964-1(a) through (e), translated into functional currency under Notice 88-70 for the tax year indicated in column 2.

**Column 5.** Enter foreign taxes paid and deemed paid (in U.S. dollars) with respect to the E&P entered in column 4. See the instructions for Schedule G on page 8 for information on reduction of foreign taxes for failure to furnish information required under section 6038.

**Column 6(b).** Enter the amount from column 6(a) translated into U.S. dollars at the appropriate exchange rate specified in section 989(b).

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## Schedule D

### Part I—Tax Deemed Paid by First-Tier Foreign Corporations Section A—Dividends Paid Out of Post-1986 Undistributed Earnings

**Column 1a.** Enter the name of the second-tier foreign corporation and the name of the first-tier foreign corporation to

which it paid a dividend out of post-1986 undistributed earnings.

**Example.** The U.S. corporation filing the return owns all of the stock of CFC1 and CFC2. CFC1 and CFC2 each own 50% of the stock of CFC3. In 2013, CFC3 pays a dividend to CFC1 and CFC2. Use one line to report dividends from CFC3 to CFC1 and another line to report dividends from CFC3 to CFC2.

**Columns 1b and 1c.** See *Reference ID numbers*, earlier.

**Column 2.** Enter the year and month in which the distributing second-tier foreign corporation's tax year ended.

**Example.** If a first-tier foreign corporation that uses the calendar year 2013 as its tax year receives dividends out of post-1986 undistributed earnings of a second-tier foreign corporation for a tax year that ended June 30, 2013, enter "201306."

**Column 3.** Enter the applicable two-letter codes from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes).

**Column 4.** Enter the second-tier foreign corporation's post-1986 undistributed earnings pool (in functional currency) for the separate category for which the schedule is being completed. See the instructions for Schedule C, Part I, column 4.

**Column 5.** Enter the opening balance in the second-tier foreign corporation's post-1986 foreign income taxes pool for the tax year indicated. See the instructions for Schedule C, Part I, column 5.

**Column 6(a).** Enter the foreign income taxes paid or accrued by the second-tier foreign corporation for the tax year indicated, translated from foreign currency into U.S. dollars using the exchange rate specified in section 986(a).

**Column 6(b).** Enter the foreign income taxes deemed paid (under section 902(b)) by the second-tier foreign corporation for the tax year indicated (from Schedule D, Part II, Section A, column 10, and Part II, Section B, column 8(b)).

**Column 8(a).** Report the sum (in the second-tier foreign corporation's functional currency) of all dividends paid out of its post-1986 undistributed earnings for the tax year indicated.

**Column 8(b).** Report the sum of the column 8(a) amounts translated into the functional currency of the first-tier foreign corporation at the spot rate in effect on the date of each distribution.

## Section B—Dividends Paid Out of Pre-1987 Accumulated Profits

Use a separate line for each dividend paid. If a dividend is paid out of the accumulated profits of more than one pre-1987 tax year, figure and show the tax deemed paid on a separate line for each tax year. In applying section 902, the IRS may determine from which tax year's accumulated profits the dividends were paid. See Regulations section 1.902-3(g)(4).

**Important.** The formula for calculating foreign taxes deemed paid by a first-tier foreign corporation under section 902(b) with respect to dividends paid by a second-tier foreign corporation in a post-1986 year out of pre-1987 accumulated profits requires that all components (dividends, accumulated profits, and taxes) be maintained in the second-tier foreign corporation's functional currency. Dividends are translated into the first-tier foreign corporation's functional currency and added to its post-1986 undistributed earnings at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(9)(ii). Foreign taxes are translated into U.S. dollars, and added to the first-tier foreign corporation's post-1986 foreign income taxes, at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(8)(ii).

**Column 1a.** Enter the name of the second-tier foreign corporation and the name of the first-tier foreign corporation to which it paid a dividend out of pre-1987 accumulated profits.

**Columns 1b and 1c.** See *Reference ID numbers*, earlier.

**Column 2.** For each pre-1987 tax year, enter the year and month in which the second-tier foreign corporation's tax year ended.

**Column 3.** Enter the applicable two-letter codes from the list at [www.irs.gov/countrycodes](http://www.irs.gov/countrycodes).

**Column 4.** For each line, enter the pre-1987 accumulated profits for the tax year indicated in column 2, computed in the second-tier corporation's functional currency under section 902. See Regulations sections 1.902-1(a)(10)(i) and (ii).

**Column 5.** Enter the foreign taxes paid and deemed paid under section 902(b) (in functional currency) with respect to the accumulated profits entered in column 4 for the pre-1987 tax year indicated in column 2. See the instructions for Schedule G below for information on reduction of foreign taxes for failure to

furnish information required under section 6038.

**Column 6(a).** Enter each dividend paid by the second-tier foreign corporation (in functional currency) to the first-tier foreign corporation out of the accumulated profits of the pre-1987 tax year indicated in column 2.

**Column 6(b).** Enter the amount from column 6(a), translated into the first-tier foreign corporation's functional currency using the spot exchange rate in effect on the date of distribution. See Regulations sections 1.902-1(a)(10)(ii) and 1.902-3(g)(1).

**Column 8(a).** Multiply column 5 by column 7. Enter the result in column 8(a).

**Column 8(b).** Enter the amount from column 8(a), translated in U.S. dollars at the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(iii).

## Part II—Tax Deemed Paid by Second-Tier Foreign Corporations

Follow the instructions for the corresponding columns of Schedule D, Part I, substituting "second-tier foreign corporation" for references to the "first-tier foreign corporation" and "third-tier foreign corporation" for references to the "second-tier foreign corporation."

**Note.** In completing Section A, column 5, note that section 902(b) as in effect prior to the Taxpayer Relief Act of 1997 did not treat any foreign taxes as deemed paid by a third- or lower-tier foreign corporation with respect to dividends received from lower-tier foreign corporations.

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## Schedule E

Use Schedule E to report foreign taxes deemed paid with respect to dividends from certain fourth-, fifth-, and sixth-tier controlled foreign corporations out of earnings accumulated in tax years beginning after August 5, 1997. Follow the instructions for the corresponding columns of Schedule D, Part I, Section A, substituting references to the next lower-tier foreign corporation as appropriate.

The post-1986 undistributed earnings and taxes pools for the eligible CFCs begin on the first day of the CFC's first tax year beginning after August 5, 1997. Earnings accumulated in tax years beginning before August 6, 1997, will be treated as pre-1987 accumulated profits for section 902 purposes. See section 902(c)(6) and Regulations section 1.902-1(a)(10)(i). Foreign income taxes attributable to these pre-pooling profits must be reduced when the associated

earnings are distributed. However, such taxes are generally not eligible for the deemed paid credit. See Regulations sections 1.902-1(a)(10)(iii) and 1.902-1(c)(8).

**Note.** In completing Part III, column 5, note that, under section 902(b) as amended by the Taxpayer Relief Act of 1997, no taxes are deemed paid by a sixth- or lower-tier foreign corporation with respect to dividends received from lower-tier foreign corporations.

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## Schedule F

Enter the gross income and definitely allocable deductions for each foreign branch (including a disregarded entity) as indicated. For each such foreign branch for which Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities, is not filed, attach an income statement, balance sheet, and schedule of remittances.

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## Schedule G

### Part I

**Line A.** If the corporation claims a deduction for percentage depletion under section 613 with respect to any part of its foreign mineral income (as defined in section 901(e)(2)) for the tax year, any foreign taxes on that income must be reduced by the smaller of:

1. The foreign taxes minus the tax on that income or
2. The tax on that income determined without regard to the deduction for percentage depletion minus the tax on that income.

The reduction must be made on a country-by-country basis (Regulations section 1.901-3(a)(1)). Attach a separate schedule showing the reduction.

**Line C.** If the corporation chooses to calculate the reduction in the foreign tax by identifying taxes specifically attributable to participation in or cooperation with an international boycott, enter the amount from Form 5713, Schedule C, line 2b. See Form 5713 and its separate Schedule C and instructions.

**Line D.** If the corporation controls a foreign corporation or partnership and fails to furnish any return or any information in any return required under section 6038(a) by the due date, reduce the foreign taxes available for credit under sections 901, 902, and 960 by 10%. If the failure continues for 90 days or more after the date of written notice by the IRS, reduce the tax by an additional 5% for each 3-month period or fraction thereof during which the failure continues after the

90-day period has expired. See section 6038(c) for limitations and special rules.

In addition, a \$10,000 penalty is imposed under section 6038(b) for failure to supply the information required under section 6038(a) for each entity within the time prescribed. If the required information is not submitted within 90 days after the IRS has mailed notice to the U.S. person, additional penalties may apply.

**Note.** The reduction in foreign taxes available for credit is reduced by any dollar penalty imposed under section 6038(b).

**Line E.** Enter foreign income taxes paid or accrued during the current tax year that have been suspended due to the rules of section 909.

### Part II

Schedule G, Part II consists of a question and a check box. Check the box if the answer to the question is "Yes." That is, check the box if, during the tax year, the corporation paid or accrued any foreign tax that was disqualified for credit under section 901(m).

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## Schedule H

### Computer-Generated Schedule H

A computer-generated Schedule H may be filed if it conforms to the IRS version. In some cases, Schedule H can be expanded to properly apportioned deductions. This applies in cases such as when the corporation:

- Has more than two product lines (under the sales method or the gross income method of apportioning R&D deductions),
- Has section 901(j) income from more than one sanctioned country, or
- Has income re-sourced by treaty for more than one country.

### Part I—Research and Development Deductions

Use Part I to apportion the research and development (R&D) deductions that cannot be definitely allocated to some item or class of gross income. Use **either** the sales method **or** one of the gross income methods described in Regulations section 1.861-17.

**Note.** The line 4 totals will generally be less than the totals on lines 1 and 2 because the line 4 totals do not include the gross income and deductions that are implicitly apportioned to the residual grouping.

### Column (a) Sales Method

Complete these columns only if the corporation elects the sales method of

apportioning R&D deductions described in Regulations section 1.861-17(c). Enter in the spaces provided the SIC Code numbers (based upon the Standard Industrial Classification System) of the product lines to which the R&D deductions relate. See Regulations section 1.861-17(a)(2)(ii) and (iii) for details on choosing SIC codes and changing a product category.

**Note.** If the corporation has more than two product lines, see *Computer-Generated Schedule H*, above.

### Columns (a)(i) and (a)(iii)

**Line 1.** Enter the worldwide gross sales for the product lines.

**Lines 3a through 3d.** Enter the gross sales that resulted in gross income for each statutory grouping.

### Columns (a)(ii) and (a)(iv)

**Line 1.** Enter the total R&D deductions connected with the product lines.

**Line 2.** Reduce the line 1 totals by legally mandated R&D (Regulations section 1.861-17(a)(4)), and a 50% exclusive apportionment amount (Regulations section 1.861-17(b)(1)(i)) if applicable.

The legally mandated R&D rules apply to R&D undertaken solely to meet legal requirements imposed by a particular political entity for improvement or marketing of specific products or processes **if** the corporation does not reasonably expect the results of that research to generate gross income (beyond de minimis amounts) outside a single geographic source.

Under the exclusive apportionment rules, 50% of the R&D deductions are apportioned exclusively to the statutory grouping of gross income, or the residual grouping of gross income, as the case may be, from the geographic source where the R&D activities which account for more than 50% of the amount of such deduction were performed. If the 50% test is **not** met, then no part of the deduction is apportioned under these rules.

**Lines 3a through 3d.** To figure the amount of R&D deductions to apportion to each statutory grouping, divide the gross sales apportioned to the statutory grouping by the worldwide gross sales for the product line. Multiply the result by the R&D deductions to be apportioned.

**Note.** If the corporation had section 901(j) income from more than one sanctioned country or had income re-sourced by treaty for more than one country, see *Computer-Generated Schedule H*, above.

**Example 1.** To determine the amount to enter on line 3a, column (a)(ii):

1. Divide the amount on line 3a, column (a)(i) by the amount on line 1, column (a)(i).
2. Multiply the result by the amount on line 2, column (a)(ii).

**Example 2.** To determine the amount to enter on line 3b, column (a)(iv):

1. Divide the amount on line 3b, column (a)(iii) by the amount on line 1, column (a)(iii).
2. Multiply the result by the amount on line 2, column (a)(iv).

### Column (b) Gross Income Methods

Complete these columns only if the corporation elects one of the gross income methods of apportioning R&D deductions described in Regulations section 1.861-17(d)(2) and (3). Check the box for the option used. Use Option 1 only if certain conditions are met. See Regulations section 1.861-17(d)(2).

**Note.** If the corporation has more than two product lines, see *Computer-Generated Schedule H*, above.

### Columns (b)(v) and (b)(vii)

**Line 1.** Enter the total gross income (excluding exempt income according to Temporary Regulations section 1.861-8T(d)(2)).

**Lines 3a through 3d.** Enter the gross income within each statutory grouping.

### Columns (b)(vi) and (b)(viii)

**Line 1.** Enter the total R&D deductions.

**Line 2.** Reduce the line 1 totals by legally mandated R&D (Regulations section 1.861-17(a)(4)), and a 25% exclusive apportionment amount (Regulations section 1.861-17(b)(1)(ii)).

**Lines 3a through 3d.** If Option 1 is checked, divide the gross income apportioned to the statutory grouping by the total gross income and multiply the result by the R&D deductions to be apportioned. If Option 2 is checked, enter the appropriate amount as described in Regulations section 1.861-17(d)(3).

### Part II—Interest Deductions, All Other Deductions, and Total Deductions

**Note.** The line 4 totals will generally be less than the totals on lines 1 and 2 because the line 4 totals do not include the gross income and deductions that are implicitly apportioned to the residual grouping.

### Columns (a)(i) through (b)(iv)

Use these columns to apportion interest deductions. See Temporary Regulations sections 1.861-8T through 1.861-13T for rules on the apportionment of interest deductions based on the fair market value, tax book value, or adjusted tax book value of assets.

If the corporation elected to use the fair market value method to apportion interest expense, see Temporary Regulations section 1.861-9T(h). Also see Rev. Proc. 2003-37, 2003-1 C.B. 950, for procedures for supplying certain documentation and information.

For tax years beginning on or after March 26, 2004, a corporation may elect to use the alternative tax book value method. See Regulations section 1.861-9(i).

Columns (a) and (b) are subdivided into "Nonfinancial Corporations" and "Financial Corporations." In allocating interest deductions, members of an affiliated group that are financial corporations must be treated as a separate affiliated group. Complete columns (a)(ii) and (b)(iv) for members of the corporation's affiliated group that are financial corporations and columns (a)(i) and (b)(iii) for members that are nonfinancial corporations.

See Regulations section 1.861-11 for the definition of an affiliated group.

### Columns (a)(i) and (a)(ii)

**Line 1a.** Enter the average of the total assets of the affiliated group. See Temporary Regulations section 1.861-9T(g)(2) for the definition of average for these purposes.

**Line 1b.** Enter the assets included on line 1a that are characterized as excess related party indebtedness. See Temporary Regulations section 1.861-10T(e) for an exception to the general rule of fungibility for excess related party indebtedness.

**Line 1c.** Enter all other assets that attract specifically allocable interest deductions. See Temporary Regulations section 1.861-10T for other exceptions to the general rule of fungibility (such as qualified nonrecourse indebtedness and integrated financial transactions).

**Line 1d.** Enter the total of the exempt assets and assets without directly identifiable yield that are to be excluded from the interest apportionment formula (Temporary Regulations sections 1.861-8T(d)(2) and 1.861-9T(g)(3)).

**Lines 3a through 3d.** The assets on line 2 are characterized as assets in one

of the statutory groupings or as belonging to the residual grouping. Enter the value of the assets in each of the statutory groupings on line 3a through 3d. See Temporary Regulations sections 1.861-9T(g)(3), 1.861-12T(g)(2), and 1.861-12T(h)(2) for the rules for characterizing the assets.

### Columns (b)(iii) and (b)(iv)

**Line 1a.** Enter the total interest deductions for the members of the corporation's affiliated group. These include any expense that is currently deductible under section 163 (including original issue discount), and interest equivalents. See Temporary Regulations section 1.861-9T for the definition of interest equivalents and a list of the sections that disallow or suspend interest deductions or require the capitalization of interest deductions.

**Line 1b.** Enter the interest deductions associated with the assets on line 1b of columns (a)(i) and (a)(ii), respectively, that attract specifically allocable interest deductions under Temporary Regulations section 1.861-10T(e).

**Note.** These interest deductions will be divided among the statutory groupings and will appear as a definitely allocable deduction in Schedule A, column 9(d).

**Line 1c.** Enter the interest deductions associated with the assets on line 1c of columns (a)(i) and (a)(ii), respectively, that attract specifically allocable interest deductions.

**Lines 3a through 3d.** To figure the amount of interest deductions to apportion to each statutory grouping, divide the assets apportioned to the grouping by the total assets apportioned and multiply the result by the interest deductions to be apportioned.

**Example 1.** To figure the amount to enter on line 3a, column (b)(iii): (a) divide the amount entered on line 3a, column (a)(i), by the amount on line 2, column (a)(i); and (b) multiply the result by the amount on line 2, column (b)(iii).

**Example 2.** To figure the amount to enter on line 3b, column (b)(iv): (a) divide the amount on line 3b, column (a)(ii) by the amount on line 2, column (a)(ii); and (b) multiply the result by the amount on line 2, column (b)(iv).

### Column (c)

Complete this column to apportion all other deductions not definitely allocable (other than interest deductions and R&D deductions). See Regulations sections 1.861-8 and 1.861-14 and Temporary

Regulations sections 1.861-8T and 1.861-14T.

**Line 1a.** Enter the total other deductions. Examples include: stewardship expenses; legal and accounting expenses; and other expenses related to certain supportive functions such as overhead, general and administrative, advertising, and marketing. Deductions for charitable contributions made on or after July 28, 2004, generally are definitely related and allocable to all gross income and apportioned solely to domestic source income.

**Lines 3a through 3d.** Enter the amounts apportioned to each statutory grouping.

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## Schedules I, J, and K

See the separate instructions for Schedule I, Schedule J, and Schedule K to see if the corporation must file these schedules.

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

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

<b>Form</b>	<b>Recordkeeping</b>	<b>Learning about the law or the form</b>	<b>Preparing and sending the form to the IRS</b>
1118	71 hr., 16 min.	17 hr., 44 min.	20 hr., 53 min.
Sch. I (Form 1118)	9 hr., 19 min.	1 hr.	1 hr., 11 min.
Sch. J (Form 1118)	22 hr., 43 min.	1 hr., 23 min.	1 hr., 49 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

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