Contents

Reminders ........................................... 1
Introduction ......................................... 1
Choosing To Take Credit or Deduction .............. 2
Why Choose the Credit? ............................ 3
Who Can Take the Credit? ......................... 5
What Foreign Taxes Qualify for the Credit? ........ 5
Foreign Taxes for Which You Cannot Take a Credit .... 7
How To Figure the Credit .......................... 11
Carryback and Carryover ......................... 23
How To Claim the Credit ......................... 25
Simple Example — Filled-In Form 1116 .......... 25
Comprehensive Example — Filled-In Form 1116 .... 26
How To Get Tax Help .............................. 37
Index .................................................. 38

Reminders

Future developments. For the latest information about developments related to Pub. 514, such as legislation enacted after it was published, go to www.irs.gov/pub514.

Alternative minimum tax. In addition to your regular income tax, you may be liable for the alternative minimum tax. A foreign tax credit may be allowed in figuring this tax. See the instructions for Form 6251, Alternative Minimum Tax—Individuals, for a discussion of the alternative minimum tax foreign tax credit.

Change of address. If your address changes from the address shown on your last return, use Form 8822, Change of Address, to notify the Internal Revenue Service.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

If you paid or accrued foreign taxes to a foreign country on foreign source income and are subject to U.S. tax on the same income, you may be able to take either a credit or an itemized deduction for those taxes. Taken as a deduction, foreign income taxes reduce your U.S. taxable income and lower your U.S. tax liability. Taken as a credit, foreign income taxes reduce your U.S. tax liability dollar-for-dollar. The credit is usually greater than the deduction.
Choosing To Take Credit or Deduction

You can choose whether to take the amount of any qualified foreign taxes paid or accrued during the year as a foreign tax credit or as an itemized deduction. You can change your choice for each year’s taxes.

To choose the foreign tax credit, in most cases you must complete Form 1116 and attach it to your U.S. tax return. However, you may qualify for the exception that allows you to claim the foreign tax credit without using Form 1116. See How To Figure the Credit, later. To choose to claim the taxes as an itemized deduction, use Schedule A (Form 1040), Itemized Deductions.

Figure your tax both ways—claiming the credit and claiming the deduction. Then fill out your return the way that benefits you more. See Why Choose the Credit, later.

Choice Applies to All Qualified Foreign Taxes

As a general rule, you must choose to take either a credit or a deduction for all qualified foreign taxes.

If you choose to take a credit for qualified foreign taxes, you must take the credit for all of them. You cannot deduct any of them. Conversely, if you choose to deduct qualified foreign taxes, you must deduct all of them. You cannot take a credit for any of them. See What Foreign Taxes Qualify for the Credit, later, for the meaning of qualified foreign taxes.

There are exceptions to this general rule, which are described next.

Exceptions for foreign taxes not allowed as a credit.

Even if you claim a credit for other foreign taxes, you can deduct any foreign tax that is not allowed as a credit if:

- You paid the tax to a country for which a credit is not allowed because it provides support for acts of international terrorism, or because the United States does not have or does not conduct diplomatic relations with it or recognizes its government and that government is not otherwise eligible to purchase defense articles or services under the Arms Export Control Act;
- You paid withholding tax on dividends from foreign corporations whose stock you did not hold for the required period of time;
- You paid withholding tax on income or gain (other than dividends) from property you did not hold for the required period of time;
- You paid withholding tax on income or gain to the extent you had to make related pay-ments on positions in substantially similar or related property;
- You participated in or cooperated with an international boycott;
- You paid taxes in connection with the purchase or sale of oil or gas, or
- You paid or accrued taxes on income or gain in connection with a covered asset acquisition. Covered asset acquisitions include certain acquisitions that result in a stepped-up basis for U.S. tax purposes. For more information, see Internal Revenue Code section 901(m). The IRS intends to issue guidance that will explain this provision in greater detail.

For more information on these items, see Taxes for Which You Can Only Take an Itemized Deduction, later, under Foreign Taxes for Which You Cannot Take a Credit.

Foreign taxes that are not income taxes. In most cases, only foreign income taxes qualify for the foreign tax credit. Other taxes, such as foreign real and personal property taxes, do not qualify. But you may be able to deduct these other taxes even if you claim the foreign tax credit for foreign income taxes.

In most cases, you can deduct these other taxes only if they are expenses incurred in a trade or business or in the production of income. However, you can deduct foreign real property taxes that are not trade or business expenses as an itemized deduction on Schedule A (Form 1040).

Carrybacks and carryovers. There is a limit on the credit you can claim in a tax year. If your qualified foreign taxes exceed the credit limit, you may be able to carry over or carry back the excess to another tax year. If you deduct qualified foreign taxes in a tax year, you cannot use a carryback or carryover in that year. That is because you cannot take both a deduction and a credit for qualified foreign taxes in the same tax year.

For more information on the limit, see How To Figure the Credit, later. For more information on carrybacks and carryovers, see Carryback and Carryover, later.

Making or Changing Your Choice

You can make or change your choice to claim a deduction or credit at any time during the period within 10 years from the regular due date for filing the return (without regard to any extension of time to file) for the tax year in which the taxes were actually paid or accrued. You make or change your choice on your tax return (or on an amended return) for the year your choice is to be effective.

Example. You paid foreign taxes for the last 13 years and chose to deduct them on your U.S. income tax returns. You were timely in both filing your returns and paying your U.S. tax liability. In February 2013, you file an amended return for tax year 2002 choosing to take a credit for your 2002 foreign taxes because you now realize that the credit is more advantageous than the deduction for that year.
Because the regular due date of your 2002 return was April 15, 2003, this choice is timely (within 10 years).

Because there is a limit on the credit for your 2002 foreign tax, you have unused 2002 foreign taxes. Ordinarily, you first carry back unused foreign taxes arising in 2002 to, and claim them as a credit in, the 2 preceding tax years. If you are unable to claim all of them in those 2 years, you carry them forward to the 10 years following the year in which they arose.

Because you originally chose to deduct your foreign taxes and the 10-year period for changing the choice for 2000 and 2001 has passed, you cannot change your choice and carry the unused 2002 foreign taxes back to tax years 2000 and 2001.

Because the 10-year periods for changing the choice have not passed for your 2003 through 2012 income tax returns, you can still choose to claim the credit for those years and carry forward any unused 2002 foreign taxes. However, you must reduce the unused 2002 foreign taxes that you carry forward by the amount that would have been allowed as a carryback if you had timely carried back the foreign tax to tax years 2000 and 2001.

You cannot take a credit or a deduction for foreign taxes paid on income you exclude under the foreign earned income exclusion or the foreign housing exclusion. See Foreign Earned Income and Housing Exclusions under Foreign Taxes for Which You Cannot Take a Credit, later.

### Why Choose the Credit?

The foreign tax credit is intended to relieve you of a double tax burden when your foreign source income is taxed by both the United States and the foreign country. In most cases, if the foreign tax rate is higher than the U.S. rate, there will be no U.S. tax on the foreign income. If the foreign tax rate is lower than the U.S. rate, U.S. tax on the foreign income will be limited to the difference between the rates. The foreign tax credit can only reduce U.S. taxes on foreign source income; it cannot reduce U.S. taxes on U.S. source income.

Although no one rule covers all situations, in most cases it is better to take a credit for qualified foreign taxes than to deduct them as an itemized deduction. This is because:

- A credit reduces your actual U.S. income tax on a dollar-for-dollar basis, while a deduction reduces only your income subject to tax,
- You can choose to take the foreign tax credit even if you do not itemize your deductions. You then are allowed the standard deduction in addition to the credit, and
- If you choose to take the foreign tax credit, and the taxes paid or accrued exceed the credit limit for the tax year, you may be able to carry over or carry back the excess to another tax year. (See Limit on credit under How To Figure the Credit, later.)

### Credit for Taxes Paid or Accrued

You can claim the credit for a qualified foreign tax in the tax year in which you pay it or accrue it, depending on your method of accounting. "Tax year" refers to the tax year for which your U.S. return is filed, not the tax year for which your foreign return is filed.

#### Accrual method of accounting.

If you use the accrual method of accounting, you can claim the credit only in the year in which you pay or accrue the tax. You are using an accrual method of accounting if you report income when you earn it, rather than when you receive it, and you deduct your expenses when you incur them, rather than when you pay them.

In most cases, foreign taxes accrue when all the events have taken place that fix the amount of the tax and your liability to pay it. Generally, this occurs on the last day of the tax year for which your foreign return is filed.

#### Contesting your foreign tax liability.

If you are contesting your foreign tax liability, you cannot accrue it and take a credit until the amount of foreign tax due is finally determined. However, if you choose to pay the tax liability you are contesting, you can take a credit for the amount of tax you pay before a final determination of foreign tax liability is made. Once your liability is determined, the foreign tax credit is allowable for the year to which the foreign tax relates. If the amount of foreign taxes taken as a credit differs from the final foreign tax liability, you may have to adjust the credit, as discussed later under Foreign Tax Redetermination.

You may have to post a bond. If you claim a credit for taxes accrued but not paid, you may have to post an income tax bond to guarantee your payment of any tax due in the event the amount of foreign tax paid differs from the amount claimed.

The IRS can request this bond at any time without regard to the Time Limit on Tax Assessment discussed later under Carryback and Carryover.

#### Cash method of accounting.

If you use the cash method of accounting, you can choose to take the credit either in the year you pay the tax or in the year you accrue it. You are using the cash method of accounting if you report income in the year you actually or constructively receive it, and deduct expenses in the year you pay them.

Choosing to take credit in the year taxes accrue. Even if you use the cash method of accounting, you can choose to take a credit for foreign taxes in the year they accrue. You make the choice by checking the box in Part II of Form 1116. Once you make that choice, you must follow it in all later years and take a credit for foreign taxes in the year they accrue.

In addition, the choice to take the credit when foreign taxes accrue applies to all foreign taxes qualifying for the credit. You cannot take a credit for some foreign taxes when paid and take a credit for others when accrued.

If you make the choice to take the credit when foreign taxes accrue and pay them in a later year, you cannot claim a deduction for any part of the previously accrued taxes.

#### Credit based on taxes paid in earlier year.

If, in earlier years, you took the credit based on taxes paid, and this year you choose to take the credit based on taxes accrued, you may be able to take the credit this year for taxes from more than one year.

Example. Last year you took the credit based on taxes paid. This year you chose to take the credit based on taxes accrued. During the year you paid foreign taxes owed for last year. You also accrued foreign income taxes for this year that you did not pay by the end of the year. You can base the credit on your return for this year on both last year’s taxes that you paid and this year’s taxes that you accrued.

### Foreign Currency and Exchange Rates

U.S. income tax is imposed on income expressed in U.S. dollars, while in most cases the foreign tax is imposed on income expressed in foreign currency. Therefore, fluctuations in the
value of the foreign currency relative to the U.S. dollar may affect the foreign tax credit.

Translating foreign currency into U.S. dollars. If you receive all or part of your income or pay some or all of your expenses in foreign currency, you must translate the foreign currency into U.S. dollars. How and when you do this depends on your functional currency. In most cases, your functional currency is the U.S. dollar unless you are required to use the currency of a foreign country.

You must make all federal income tax determinations in your functional currency. The U.S. dollar is the functional currency for all taxpayers except some qualified business units. A qualified business unit is a separate and clearly identified unit of a trade or business that maintains separate books and records. Unless you are self-employed, your functional currency is the U.S. dollar.

Even if you are self-employed and have a qualified business unit, your functional currency is the U.S. dollar if any of the following apply:

- You conduct the business primarily in dollars.
- The principal place of business is located in the United States.
- You choose to or are required to use the dollar as your functional currency.
- The business books and records are not kept in the currency of the economic environment in which a significant part of the business activities is conducted.

If your functional currency is the U.S. dollar, you must immediately translate into dollars all items of income, expense, etc., that you receive, pay, or accrue in a foreign currency and that will affect computation of your income tax.

If there is more than one exchange rate, use the one that most properly reflects your income. In most cases, you can get exchange rates from banks and U.S. Embassies.

If your functional currency is not the U.S. dollar, you must make all income tax determinations in your functional currency. At the end of the year, translate the results, such as income or loss, into U.S. dollars to report on your income tax return.

For more information, write to:

Internal Revenue Service
International Section
Philadelphia, PA 19255-0725

Rate of exchange for foreign taxes paid. Use the rate of exchange in effect on the date you paid the foreign taxes to the foreign country unless you meet the exception discussed next. If your tax was withheld in foreign currency, use the rate of exchange in effect for the date on which the tax was withheld. If you make foreign estimated tax payments, use the rate of exchange in effect for the date on which you made the estimated tax payment.

The exchange rate rules discussed here apply even if the foreign taxes are paid or accrued with respect to a foreign tax credit splitting event (discussed later).

Exception. If you claim the credit for foreign taxes on an accrual basis, in most cases you must use the average exchange rate for the tax year to which the taxes relate. This rule applies to accrued taxes relating to tax years beginning after 1997 and only under the following conditions:

1. The foreign taxes are paid on or after the first day of the tax year to which they relate.
2. The foreign taxes are paid not later than 2 years after the close of the tax year to which they relate.
3. The foreign tax liability is not denominated in an inflationary currency (defined in the Form 1116 instructions). (This condition applies to taxes paid or accrued in tax years beginning after November 6, 2007.)

For all other foreign taxes, you should use the exchange rate in effect on the date you paid them.

Election to use exchange rate on date paid. If you have accrued foreign taxes that you are otherwise required to convert using the average exchange rate, you may elect to use the exchange rate in effect on the date the foreign taxes are paid if the taxes are denominated in a nonfunctional foreign currency. If any of the accrued taxes are unpaid, you must translate them into U.S. dollars using the exchange rate on the last day of the U.S. tax year to which those taxes relate. You may make the election for all nonfunctional currency foreign income taxes or only those nonfunctional currency foreign income taxes that are attributable to qualified business units with a U.S. dollar functional currency. Once made, the election applies to the tax year for which made and all subsequent tax years unless revoked with the consent of the IRS. The election is available for tax years beginning after 2004. It must be made by the due date (including extensions) for filing the tax return for the first tax year to which the election applies. Make the election by attaching a statement to the applicable tax return. The statement must identify whether the election is made for all foreign taxes or only for foreign taxes attributable to qualified business units with a U.S. dollar functional currency.

Foreign Tax Redetermination

A foreign tax redetermination is any change in your foreign tax liability that may affect your U.S. foreign tax credit claimed.

The year in which to claim the credit remains the year to which the foreign taxes paid or accrued relate, even if the change in foreign tax liability occurs in a later year.

If a foreign tax redetermination occurs, a redetermination of your U.S. tax liability is required if any of the following conditions apply:

1. The accrued taxes when paid differ from the amounts claimed as a credit.
2. The accrued taxes you claimed as a credit in one tax year are not paid within 2 years after the end of that tax year.

If this applies to you, you must reduce the credit previously claimed by the amount of the unpaid taxes. You will not be allowed a credit for the unpaid taxes until you pay them. When you pay the accrued taxes, a new foreign tax redetermination occurs and you must translate the taxes into U.S. dollars using the exchange rate as of the date they were paid. The foreign tax credit is allowed for the year to which the foreign tax relates. See Rate of exchange for foreign taxes paid, earlier, under Foreign Currency and Exchange Rates.

3. The foreign taxes you paid are refunded in whole or in part.
4. For taxes taken into account when accrued but translated into dollars on the date of payment, the dollar value of the accrued tax differs from the dollar value of the tax paid because of fluctuations in the exchange rate between the date of accrual and the date of payment. However, no redetermination is required if the change in foreign tax liability for each foreign country is solely attributable to exchange rate fluctuations and is less than the smaller of:
   a. $10,000, or
   b. 2% of the total dollar amount of the foreign tax initially accrued for that foreign country for the U.S. tax year.

In this case, you must adjust your U.S. tax in the tax year in which the accrued foreign taxes are paid.

Notice to the Internal Revenue Service (IRS) of Redetermination

You are required to notify the IRS about a foreign tax credit redetermination that affects your U.S. tax liability for each tax year affected by the redetermination. In most cases, you must file Form 1040X, Amended U.S. Individual Income Tax Return, with a revised Form 1116 if you claim the credit for foreign income taxes that are attributable to qualified business units with a U.S. dollar functional currency. Once made, the election applies to the tax year for which made and all subsequent tax years unless revoked with the consent of the IRS. The election is available for tax years beginning after 2004. It must be made by the due date (including extensions) for filing the tax return for the first tax year to which the election applies. Make the election by attaching a statement to the applicable tax return. The statement must identify whether the election is made for all foreign taxes or only for foreign taxes attributable to qualified business units with a U.S. dollar functional currency.

Foreign Tax Redetermination

A foreign tax redetermination is any change in your foreign tax liability that may affect your U.S. foreign tax credit claimed.

The year in which to claim the credit remains the year to which the foreign taxes paid or accrued relate, even if the change in foreign tax liability occurs in a later year.

If a foreign tax redetermination occurs, a redetermination of your U.S. tax liability is required if any of the following conditions apply:

1. The amount of your creditable taxes paid or accrued during the tax year is not more than $300 ($600 if married filing a joint return) as a result of the foreign tax redetermination, and
2. You meet the requirements listed under Exemption from foreign tax credit limit under How To Figure the Credit, later.

There are other exceptions to this requirement. They are discussed later under Due date of notification to IRS.

Contents of statement. The statement must include all of the following:

- Your name, address, and taxpayer identification number.
- The tax year or years that are affected by the foreign tax redetermination.
- The date or dates the foreign taxes were accrued, if applicable.
The date or dates the foreign taxes were paid.
The amount of foreign taxes paid or accrued on each date (in foreign currency) and the exchange rate used to translate each amount.
Information sufficient to determine any interest due from or owing to you, including the amount of any interest paid to you by the foreign government and the dates received.

In the case of any foreign taxes that were not paid before the due date two years after the close of the tax year to which those taxes relate, you must provide the amount of those taxes in foreign currency and the exchange rate that was used to translate each amount when originally claimed as a credit.

If any foreign tax was refunded in whole or in part, you must provide the date and amount (in foreign currency) of each refund, the exchange rate that was used to translate each amount when originally claimed as a credit, and the exchange rate for the date the refund was received (for purposes of computing foreign currency gain or loss under Internal Revenue Code section 988).

Due date of notification to IRS. If you pay less foreign tax than you originally claimed a credit for, in most cases you must file a notification by the due date (with extensions) of your original return for your tax year in which the foreign tax redetermination occurred. There is no limit on the time the IRS has to redetermine and assess the correct U.S. tax due. If you pay more foreign tax than you originally claimed a credit for, you have 10 years to file a claim for refund of U.S. taxes. See Time Limit on Refund Claims, later.

Exceptions to this due date are explained in the next two paragraphs.

Multiple redeterminations of U.S. tax liability for same tax year. Where more than one foreign tax redetermination requires a redetermination of U.S. tax liability for the same tax year and those redeterminations occur in the same tax year or within two consecutive tax years, you can file for that tax year one notification (Form 1040X with a Form 1116 and the required statement) that reflects all those tax redeterminations. If you choose to file one notification, the due date for that notification is the due date of the original return (with extensions) for the year in which the first foreign tax redetermination that reduced your foreign tax liability occurred. However, foreign tax redeterminations with respect to the tax year for which a redetermination of U.S. tax liability is required may occur after the due date for providing that notification. In this situation, you may have to file more than one Form 1040X for that tax year.

Additional U.S. tax due eliminated by foreign tax credit carryback or carryover. If a foreign tax redetermination requires a redetermination of U.S. tax liability that would otherwise result in an additional amount of U.S. tax due, but the additional tax is eliminated by a carryback or carryover of an unused foreign tax, you do not have to amend your tax return for the year affected by the redetermination. Instead, you can notify the IRS by attaching a statement to the original return for the tax year in which the foreign tax redetermination occurred. You must file the statement by the due date (with extensions) of that return. The statement must show the amount of the unused foreign taxes paid or accrued and a detailed schedule showing the computation of the carryback or carryover (including the amounts carried back or over to the year for which a redetermination on U.S. tax liability is required).

Failure-to-notify penalty. If you fail to notify the IRS of a foreign tax redetermination and cannot show reasonable cause for the failure, you may have to pay a penalty.

For each month, or part of a month, that the failure continues, you pay a penalty of 5% of the tax due resulting from a redetermination of your U.S. tax. This penalty cannot be more than 25% of the tax due.

Foreign tax refund. If you receive a foreign tax refund without interest from the foreign government, you will not have to pay interest on the amount of tax due resulting from the adjustment to your U.S. tax for the time before the date of the refund.

However, if you receive a foreign tax refund with interest, you must pay interest to the IRS up to the amount of the interest paid to you by the foreign government. The interest you must pay cannot be more than the interest you would have had to pay on taxes that were unpaid for any other reason for the same period. Interest also is owed from the time you receive a refund until you pay the additional tax due.

Foreign tax imposed on foreign refund. If your foreign tax refund is taxed by the foreign country, you cannot take a separate credit or deduction for this additional foreign tax. However, when you refigure the foreign tax credit taken for the original foreign tax, reduce the amount of the refund by the foreign tax paid on the refund.

Example. You paid a foreign income tax of $3,000 in 2011, and received a foreign tax refund of $500 in 2013 on which a foreign tax of $100 was imposed. When you refigure your credit for 2011, you must reduce the $3,000 you paid by $400.

Time Limit on Refund Claims

You have 10 years to file a claim for refund of U.S. tax if you find that you paid or accrued a larger foreign tax than you claimed a credit for. The 10-year period begins the day after the regular due date for filing the return (without extensions) for the year in which the taxes were actually paid or accrued.

You have 10 years to file your claim regardless of whether you claim the credit for taxes paid or taxes accrued. The 10-year period applies to claims for refund or credit based on:

1. Fixing math errors in figuring qualified foreign taxes,
2. Reporting qualified foreign taxes not originally reported on the return,
3. Any other change in the size of the credit (including one caused by correcting the foreign tax credit limit).

The special 10-year period also applies to making or changing your choice to claim a deduction or credit for foreign taxes. See Making or Changing Your Choice discussed earlier under Choosing To Take Credit or Deduction.

Who Can Take the Credit?

U.S. citizens, resident aliens, and nonresident aliens who paid foreign income tax and are subject to U.S. tax on foreign source income may be able to take a foreign tax credit.

U.S. Citizens

If you are a U.S. citizen, you are taxed by the United States on your worldwide income wherever you live. You are normally entitled to take a credit for foreign taxes you pay or accrue.

Resident Aliens

If you are a resident alien of the United States, you can take a credit for foreign taxes subject to the same general rules as U.S. citizens. If you are a bona fide resident of Puerto Rico for the entire tax year, you also come under the same rules.

Usually, you can take a credit only for those foreign taxes imposed on income you actually or constructively received while you had resident alien status.

For information on alien status, see Publication 519.

Nonresident Aliens

If you are a nonresident alien, you cannot take the credit in most cases. However, you may be able to take the credit if:

• You were a bona fide resident of Puerto Rico during your entire tax year, or
• You pay or accrue tax to a foreign country or U.S. possession on income from foreign sources that is effectively connected with a trade or business in the United States. But if you must pay tax to a foreign country or U.S. possession on income from U.S. sources only because you are a citizen or a resident of that country or U.S. possession, do not use that tax in figuring the amount of your credit.

For information on alien status and effectively connected income, see Publication 519.

What Foreign Taxes Qualify for the Credit?

In most cases, the following four tests must be met for any foreign tax to qualify for the credit.

1. The tax must be imposed on you.
Tax Must Be Imposed on You

You can claim a credit only for foreign taxes that are imposed on you by a foreign country or U.S. possession. For example, a tax that is deducted from your wages is considered to be imposed on you. You cannot shift the right to claim the credit by contract or other means.

Foreign country. A foreign country includes any foreign state and its political subdivisions. Income, war profits, and excess profits taxes paid or accrued to a foreign country or province qualify for the foreign tax credit.

U.S. possessions. For foreign tax credit purposes, all qualified taxes paid to U.S. possessions are considered foreign taxes. For this purpose, U.S. possessions include Puerto Rico and American Samoa.

When the term “foreign country” is used in this publication, it includes U.S. possessions unless otherwise stated.

You Must Have Paid or Accrued the Tax

In most cases, you can claim the credit only if you paid or accrued the foreign tax to a foreign country or U.S. possession. However, the paragraphs that follow describe some instances in which you can claim the credit even if you did not directly pay or accrue the tax yourself.

Joint return. If you file a joint return, you can claim the credit based on the total foreign income taxes paid or accrued by you and your spouse.

Combined income. If foreign tax is imposed on the combined income of two or more persons (for example, spouses), the tax is allocated among, and considered paid by, these persons on a pro rata basis in proportion to each person’s portion of the combined income, as determined under foreign law and Regulations section 1.901-2(f)(3)(iii). Combined income with respect to each foreign tax that is imposed on a combined basis (and combined income subject to tax exemption or preferential tax rates) is computed separately, and the tax on that combined income is allocated separately.

These rules apply to foreign taxes paid or accrued in tax years beginning after February 14, 2012. However, you can choose to apply the new rules to foreign taxes paid or accrued in tax years beginning after December 31, 2010, and before February 15, 2012. For more details, see paragraphs (f) and (h) of Regulations section 1.901-2. For similar rules applicable to prior tax years, see Regulations section 1.901-2 (revised as of April 1, 2011).

Example. You and your spouse reside in Country X, which imposes income tax on your combined incomes. Both of you use the “u” as your functional currency. Country X apportions tax based on income. You had income of 30,000u, and your spouse had income of 20,000u. Your filing status on your U.S. income tax return is married filing separately. You can claim only 60% (30,000u/50,000u) of the foreign tax imposed on your income or your U.S. income tax return. Your spouse can claim only 40% (20,000u/50,000u).

Partner or S corporation shareholder. If you are a member of a partnership, or a shareholder in an S corporation, you can claim the credit based on your proportionate share of the foreign income taxes paid or accrued by the partnership or the S corporation. These amounts will be shown on the Schedule K-1 you receive from the partnership or S corporation. However, if you are a shareholder in an S corporation that in turn owns stock in a foreign corporation, you cannot claim a credit for your share of foreign taxes paid by the foreign corporation.

Beneficiary. If you are a beneficiary of an estate or trust, you may be able to claim the credit based on your proportionate share of foreign income taxes paid or accrued by the estate or trust. This amount will be shown on the Schedule K-1 you receive from the estate or trust. However, you must show that the tax was imposed on income of the estate and not on income received by the decedent.

Mutual fund shareholder. If you are a shareholder of a mutual fund or other regulated investment company (RIC), you may be able to claim the credit based on your proportionate share of foreign income taxes paid or accrued by the fund if it chooses to pass the credit on to its shareholders. You should receive from the mutual fund or other RIC a Form 1099-DIV, or similar statement, showing your share of the foreign income, and your share of the foreign taxes paid. If you do not receive this information, you will need to contact the fund.

Controlled foreign corporation shareholder. If you are a shareholder of a controlled foreign corporation and choose to be taxed at corporate rates on the amount you must include in gross income from that corporation, you can claim the credit based on your share of foreign taxes paid or accrued by the controlled foreign corporation. If you make this election, you must claim the credit by filing Form 1118, Foreign Tax Credit—Corporations.

Controlled foreign corporation. A controlled foreign corporation is a foreign corporation in which U.S. shareholders own more than 50% of the voting power or value of the stock. You are considered a U.S. shareholder if you own, directly or indirectly, 10% or more of the total voting power of all classes of the foreign corporation’s stock. See Internal Revenue Code sections 951(b) and 958(b) for more information.

Tax Must Be the Legal and Actual Foreign Tax Liability

The amount of foreign tax that qualifies is not necessarily the amount of tax withheld by the foreign country. Only the legal and actual foreign tax liability that you paid or accrued during the year qualifies for the credit.

Foreign tax refund. You cannot take a foreign tax credit for income taxes paid to a foreign country if it is reasonably certain the amount would be refunded, credited, rebated, abated, or forgiven if you made a claim.

For example, the United States has tax treaties with many countries allowing U.S. citizens and residents reductions in the rates of tax of those foreign countries. However, some treaty countries require U.S. citizens and residents to pay the tax figured without regard to the lower treaty rates and then claim a refund for the amount by which the tax actually paid is more than the amount of tax figured using the lower treaty rate. The qualified foreign tax is the amount figured using the lower treaty rate and not the amount actually paid, because the excess tax is refundable.

Subsidy received. Tax payments a foreign country returns to you in the form of a subsidy do not qualify for the foreign tax credit. This rule applies even if the subsidy is given to a person related to you, or persons who participated with you in a transaction or a related transaction. A subsidy can be provided by any means but must be determined, directly or indirectly, in relation to the amount of tax, or to the base used to figure the tax.

The term “subsidy” includes any type of benefit. Some ways of providing a subsidy are refunds, credits, deductions, payments, or discharges of obligations.

Shareholder receiving refund for corporate tax in integrated system. Under some foreign tax laws and treaties, a shareholder is considered to have paid part of the tax that is imposed on the corporation. You may be able to claim a refund of these taxes from the foreign government. You must include the refund (including any amount withheld) in your income in the year received. Any tax withheld from the refund is a qualified foreign tax.

Example. You are a shareholder of a French corporation. You receive a $100 refund of the tax paid to France by the corporation on the earnings distributed to you as a dividend. The French government imposes a 15% withholding tax ($15) on the refund you received. You receive a check for $85. You include $100 in your income. The $15 of tax withheld is a qualified foreign tax.

Tax Must Be an Income Tax (or Tax in Lieu of Income Tax)

In most cases, only income, war profits, and excess profits taxes (income taxes) qualify for the foreign tax credit. Foreign taxes on wages, dividends, interest, and royalties qualify for the
Income Tax

Simply because the levy is called an income tax by the foreign taxing authority does not make it an income tax for this purpose. A foreign levy is an income tax only if it meets both of the following requirements.

1. It is a tax; that is, you have to pay it and you get no specific economic benefit (discussed below) from paying it.
2. The predominant character of the tax is that of an income tax in the U.S. sense.

A foreign levy may meet these requirements even if the foreign tax law differs from U.S. tax law. The foreign law may include in income items that U.S. law does not include, or it may allow certain exclusions or deductions that U.S. law does not allow.

Specific economic benefit. In most cases, you get a specific economic benefit if you receive, or are considered to receive, an economic benefit from the foreign country imposing the levy, and:

1. If there is a generally imposed income tax, the economic benefit is not available on substantially the same terms to all persons subject to the income tax, or
2. If there is no generally imposed income tax, the economic benefit is not available on substantially the same terms to the population of the foreign country in general.

You are considered to receive a specific economic benefit if you have a business transaction with a person who receives a specific economic benefit from the foreign country and, under the terms and conditions of the transaction, you receive directly or indirectly all or part of the benefit. However, see the exception discussed later under Pension, unemployment, and disability fund payments.

Economic benefits. Economic benefits include the following.

• Goods.
• Services.
• Fees or other payments.
• Rights to use, acquire, or extract resources, patents, or other property the foreign country owns or controls.
• Discharges of contractual obligations.

In most cases, the right or privilege merely to engage in business is not an economic benefit.

Dual-capacity taxpayers. If you are subject to a foreign country’s levy and you also receive a specific economic benefit from that foreign country, you are a “dual-capacity taxpayer.” As a dual-capacity taxpayer, you cannot claim a credit for any part of the foreign levy, unless you establish that the amount paid under a distinct element of the foreign levy is a tax, rather than a compulsory payment for a direct or indirect specific economic benefit.

Foreign Taxes for Which You Cannot Take a Credit

This part discusses the foreign taxes for which you cannot take a credit. These are:

• Taxes on excluded income,
• Taxes for which you can only take an itemized deduction,
• Taxes on foreign mineral income,
• Taxes from international boycott operations,
• A portion of taxes on combined foreign oil and gas income,
• Taxes of U.S. persons controlling foreign corporations and partnerships who fail to file required information returns, and
• Taxes related to a foreign tax splitting event.

Taxes on Excluded Income

You cannot take a credit for foreign taxes paid or accrued on certain income that is excluded from U.S. gross income.

Foreign Earned Income and Housing Exclusions

You must reduce your foreign taxes available for the credit by the amount of those taxes paid or accrued on income that is excluded from U.S. income under the foreign earned income exclusion or the foreign housing exclusion. See Publication 54 for more information on the foreign earned income and housing exclusions.

Wages completely excluded. If your wages are completely excluded, you cannot take a credit for any of the foreign taxes paid or accrued on these wages.

Wages partly excluded. If only part of your wages is excluded, you cannot take a credit for the foreign income taxes allocable to the excluded part. You find the amount allocable to your excluded wages by multiplying the foreign tax paid or accrued on foreign earned income received or accrued during the tax year by a fraction.

The numerator of the fraction is your foreign earned income and housing amounts excluded under the foreign earned income and housing exclusions for the tax year minus otherwise deductible expenses definitely related and properly apportioned to that income. Deductible expenses do not include the foreign housing deduction.

The denominator is your total foreign earned income received or accrued during the tax year minus all deductible expenses allocable to that income.
income (including the foreign housing deduction). If the foreign law taxes foreign earned income and some other income (for example, earned income from U.S. sources or a type of income not subject to U.S. tax), and the taxes on the other income cannot be segregated, the denominator of the fraction is the total amount of income subject to the foreign tax minus deductible expenses allocable to that income.

**Example.** You are a U.S. citizen and a cash basis taxpayer, employed by Company X and living in Country A. Your records show the following:

- Foreign earned income received: $125,000
- Unreimbursed business travel expenses: $20,000
- Income tax paid to Country A: $30,000
- Exclusion of foreign earned income and housing allowance: $97,600

Because you can exclude part of your wages, you cannot claim a credit for part of the foreign taxes. To find that part, do the following.

First, find the amount of business expenses allocable to excluded wages and therefore not deductible. To do this, multiply the otherwise deductible expenses by a fraction. That fraction is the excluded wages over your foreign earned income.

$$\frac{20,000}{125,000} = 0.16$$

Next, find the numerator of the fraction by which you will multiply the foreign taxes paid. To do this, subtract business expenses allocable to excluded wages ($15,616) from excluded wages ($97,600). The result is $81,984.

Then, find the denominator of the fraction by subtracting all your deductible expenses from all your foreign earned income ($125,000 − $20,000 − $105,000).

Finally, multiply the foreign tax you paid by the resulting fraction.

$$\frac{30,000}{81,984} \times \frac{81,984}{105,000} = \frac{23,424}{97,600}$$

The amount of Country A tax you cannot take a credit for is $23,424.

**Extraterritorial Income Exclusion**

You cannot take a credit for taxes you pay on qualifying foreign trade income excluded on Form 8873, Extraterritorial Income Exclusion. However, see Internal Revenue Code section 943(d) for an exception for certain withholding taxes.

**Taxes for Which You Can Only Take an Itemized Deduction**

You cannot claim a foreign tax credit for foreign income taxes paid or accrued under the following circumstances. However, you can claim an itemized deduction for these taxes. See **Choosing To Take Credit or Deduction**, earlier.

**Taxes Imposed By Sanctioned Countries (Section 901(j) Income)**

You cannot claim a foreign tax credit for foreign income taxes paid or accrued to any country if the income giving rise to the tax is for a period (the sanction period) during which:
- The Secretary of State has designated the country as one that repeatedly provides support for acts of international terrorism,
- The United States has severed or does not conduct diplomatic relations with the country,
- The United States does not recognize the country’s government, and that government is not otherwise eligible to purchase defense articles or services under the Arms Export Control Act.

The following countries meet this description for 2013. Income taxes paid or accrued to these countries in 2013 do not qualify for the credit.
- Cuba.
- Iran.
- Libya (but see Note later).
- North Korea.
- Sudan.
- Syria.

**Waiver of denial of the credit.** A waiver can be granted to a sanctioned country if the President of the United States determines that granting the waiver is in the national interest of the United States and will expand trade and investment opportunities for U.S. companies in the sanctioned country. The President must report to Congress his intentions to grant the waiver and his reasons for granting the waiver not less than 30 days before the date on which the waiver is granted.

**Note.** Effective December 10, 2004, the President granted a waiver to Libya. Income taxes arising on or after this date qualify for the credit if they meet the other requirements in this publication.

**Limit on credit.** In figuring the foreign tax credit limit, discussed later, income from a sanctioned country is a separate category of foreign income unless a Presidential waiver is granted. You must fill out a separate Form 1116 for this income. This will prevent you from claiming a credit for foreign taxes paid or accrued to the sanctioned country.

**Example.** You lived and worked in Iran until August, when you were transferred to Italy. You paid taxes to each country on the income earned in that country. You cannot claim a foreign tax credit for the foreign taxes paid on the income earned in Iran. Because the income earned in Iran is a separate category of foreign income, you must fill out a separate Form 1116 for that income. You cannot take a credit for taxes paid on the income earned in Iran, but that income is taxable by the United States.

**Figuring the credit when a sanction ends.** Table 1 lists the countries for which sanctions have ended or for which a Presidential waiver has been granted. For any of these countries, you can claim a foreign tax credit for the taxes paid or accrued to that country on the income for the period that begins after the end of the sanction period or the date the Presidential waiver was granted.

**Amounts for the nonsanctioned period.** If a sanction period ends (or a Presidential waiver is granted) during your tax year and you are not able to determine the actual income and taxes for that period, you can allocate amounts to that period based on the number of days in the period that fall in your tax year. Multiply the income or taxes for the year by the following fraction to determine the amounts allocable to that period.

$$\frac{173}{365} \times \frac{20,000}{9,479} = \frac{9,479}{1116}$$

You would figure the tax for the nonsanctioned period as follows.

$$\frac{173}{365} \times \frac{4,500}{2,133} = \frac{2,133}{1116}$$

To figure your foreign tax credit, you would use $9,479 as the income from Country X and $2,133 as the tax.
Further Information. The rules for figuring the foreign tax credit after a country’s sanction period ends are more fully explained in Revenue Ruling 92-62, Cumulative Bulletin 1992-2, page 193. This Cumulative Bulletin can be found in many libraries and IRS offices.

Taxes Imposed on Certain Dividends

You cannot claim a foreign tax credit for withholding tax (defined later) on dividends paid or accrued if either of the following applies to the dividends:

1. The dividends are on stock you held for less than 16 days during the 31-day period that begins 15 days before the ex-dividend date (defined later).

2. The dividends are for a period or periods totaling more than 366 days on preferred stock you held for less than 46 days during the 91-day period that begins 45 days before the ex-dividend date. If the dividend is not for more than 366 days, rule (1) applies to the preferred stock.

When figuring how long you held the stock, count the day you sold it, but do not count the day you acquired it or any days on which you were protected from risk of loss.

Regardless of how long you held the stock, you cannot claim the credit to the extent you have an obligation under a short sale or otherwise to make payments related to the dividend for positions in substantially similar or related property.

Withholding tax. For this purpose, withholding tax includes any tax determined on a gross basis. It does not include any tax which is in the nature of a prepayment of a tax imposed on a net basis.

Ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the purchaser of a stock is not entitled to receive the next dividend payment.

Example 1. You bought common stock from a foreign corporation on November 3. You sold the stock on November 19. You received a dividend on this stock because you owned it on the ex-dividend date of November 5. To claim the credit, you must have held the stock for at least 16 days within the 31-day period that begins on October 21 (15 days before the ex-dividend date). Because you held the stock for 16 days, from November 4 until November 19, you are entitled to the credit.

Example 2. The facts are the same as in Example 1 except that you sold the stock on November 14. You held the stock for only 11 days. You are not entitled to the credit.

Exception. If you are a securities dealer who actively conducts business in a foreign country, you may be able to claim a foreign tax credit for qualified taxes paid on dividends regardless of how long you held the stock or whether you were obligated to make payments for positions in substantially similar or related property. See section 901(k)(4) of the Internal Revenue Code for more information.

<table>
<thead>
<tr>
<th>Country</th>
<th>Starting Date</th>
<th>Ending Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iraq</td>
<td>February 1, 1991</td>
<td>June 27, 2004</td>
</tr>
<tr>
<td>Libya</td>
<td>January 1, 1987</td>
<td>December 9, 2004*</td>
</tr>
</tbody>
</table>


Taxes Withheld on Income or Gain (Other Than Dividends)

For income or gain (other than dividends) paid or accrued on property, you cannot claim a foreign tax credit for withholding tax (defined later):

- If you have not held the property for at least 16 days during the 31-day period that begins 15 days before the date on which the right to receive the payment arises, or
- To the extent you have to make related payments on positions in substantially similar or related property.

When figuring how long you held the property, count the day you sold it, but do not count the day you acquired it or any days on which you were protected from risk of loss.

Withholding tax. For this purpose, withholding tax includes any tax determined on a gross basis. It does not include any tax which is in the nature of a prepayment of a tax imposed on a net basis.

Exception for dealers. If you are a dealer in property who actively conducts business in a foreign country, you may be able to claim a foreign tax credit for qualified taxes withheld on income or gain from that property regardless of how long you held it or whether you have to make related payments on positions in substantially similar or related property. See section 901(l)(2) of the Internal Revenue Code for more information.

Covered Asset Acquisition

You cannot take a credit for the disqualified portion of any foreign tax paid or accrued in connection with a covered asset acquisition. A covered asset acquisition includes certain acquisitions that result in a stepped-up basis for U.S. tax purposes but not for foreign tax purposes. For more information, see Internal Revenue Code section 901(m). The IRS intends to issue guidance that will explain this provision in greater detail.

Taxes in Connection With the Purchase or Sale of Oil or Gas

You cannot claim a foreign tax credit for taxes paid or accrued to a foreign country in connection with the purchase or sale of oil or gas extracted in that country if you do not have an economic interest in the oil or gas, and the purchase price or sales price is different from the fair market value of the oil or gas at the time of purchase or sale.

Taxes on Foreign Mineral Income

You must reduce any taxes paid or accrued to a foreign country or possession on mineral income from that country or possession if you were allowed a deduction for percentage depletion for any part of the mineral income. For details, see Regulations section 1.901-3.

Taxes From International Boycott Operations

If you participate in or cooperate with an international boycott during the tax year, your foreign taxes resulting from boycott activities will reduce the total taxes available for credit. See the instructions for line 12 in the Form 1116 instructions to figure this reduction.

In most cases, this rule does not apply to employees with wages who are working and living in boycotting countries, or to retirees with pensions who are living in these countries.

List of boycotting countries. A list of the countries which may require participation in or cooperation with an international boycott is published by the Department of the Treasury. As of November 2013, the following countries are listed:

- Iraq
- Kuwait
- Lebanon
- Libya
- Qatar
- Saudi Arabia
- Syria
- United Arab Emirates
- Yemen

For information concerning changes to the list, write to:

Internal Revenue Service
International Section
Philadelphia, PA 19255-0725

Determinations of whether the boycott rule applies. You may request a determination from the Internal Revenue Service as to whether a particular operation constitutes participation in or cooperation with an international boycott. The procedures for obtaining a determination from the Service are outlined in

Publication 514 (2013)
them there.

Public inspection. A determination and any related background file is open to public inspection. However, your identity and certain other information will remain confidential.

Reporting requirements. You must file a report with the IRS if you or any of the following persons have operations in or related to a boycotting country or with the government, a company, or a national of a boycotting country.

- A foreign corporation in which you own 10% or more of the voting power of all voting stock but only if you own the stock of the foreign corporation directly or through foreign entities.
- A partnership in which you are a partner.
- A trust you are treated as owning.

Form 5713 required. If you have to file a report, you must use Form 5713, International Boycott Report, and attach all supporting schedules. See the Instructions for Form 5713 for information on when and where to file the form.

Penalty for failure to file. If you willfully fail to make a report, in addition to other penalties, you may be fined $25,000 or imprisoned for no more than one year, or both.

Taxes on Combined Foreign Oil and Gas Income

You must reduce your foreign taxes by a portion of any foreign taxes imposed on combined foreign oil and gas income. The amount of the reduction is the amount by which your foreign oil and gas taxes exceed the amount of your combined foreign oil and gas income multiplied by a fraction equal to your pre-credit U.S. tax liability (Form 1040, line 4) divided by your worldwide taxable income. You may be entitled to carry over to other years taxes reduced under this rule. See Internal Revenue Code section 907(f).

Combined foreign oil and gas income means the sum of foreign oil related income and foreign oil and gas extraction income. Foreign oil and gas taxes are the sum of foreign oil and gas extraction taxes and foreign oil related taxes.

Taxes of U.S. Persons Controlling Foreign Corporations and Partnerships

If you had control of a foreign corporation or a foreign partnership for the annual accounting period of that corporation or partnership that ended with or within your tax year, you may have to file an annual information return on Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations. Under this rule, you generally had control of a foreign corporation if at any time during your tax year you owned:

- Stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote, or
- More than 50% of the total value of shares of all classes of stock of the foreign corporation.

U.S. persons controlling foreign partnerships. If you are a U.S. citizen or resident who had control of a foreign partnership at any time during the partnership's tax year, you may have to file an annual information return on Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. Under this rule, you generally had control of the partnership if you owned more than 50% of the capital or profits interest, or an interest to which 50% of the deductions or losses were allocated.

U.S. persons controlling foreign partnerships. If you are a U.S. citizen or resident who had control of a foreign partnership at any time during the tax year of the partnership, you owned 10% or greater interest in the partnership while the partnership was controlled by U.S. persons owning at least a 10% interest. See the Instructions for Form 8865 for more information.

Penalty for not filing Form 5471 or Form 8865. In most cases, there is a penalty of $10,000 for each annual accounting period for which you fail to furnish information. Additional penalties apply if the failure continues for more than 90 days after the day the IRS mails you notice of the failure to furnish the information.

If you fail to file either Form 5471 or Form 8885 when due, you may also be required to reduce by 10% all foreign taxes that may be used for the foreign tax credit. Additional reductions apply if the failure continues for 90 days or more after the date the IRS mails you notice of the failure to furnish the information. The total reductions shall not exceed the greater of $10,000 or the income of the foreign corporation or foreign partnership for the accounting period for which the failure occurs. This foreign tax credit penalty is also reduced by the amount of the dollar penalty imposed.

Taxes Related to a Foreign Tax Credit Splitting Event

Reduce taxes paid or accrued by any taxes paid or accrued with respect to a foreign tax credit splitting event. For foreign taxes paid or accrued in tax years beginning after 2010, if there is a foreign tax credit splitting event, you may not take the foreign tax into account before the tax year in which you take the income into account. There is a foreign tax credit splitting event with respect to a foreign income tax if (in connection with a splitting arrangement listed below) the related income is (or will be) taken into account by a covered person. A covered person is either of the following:

- An entity in which you hold, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value).
- Any person who is related to you. For a list of related persons, see Nondeductible Loss in Publication 544, chapter 2.

A covered asset acquisition under Internal Revenue Code section 901(m) is not a foreign tax credit splitting event under Internal Revenue Code section 909.

For more information, see section 909 and any regulations under that section.

Splitter arrangements. The following paragraphs summarize the splitter arrangements. For more details, see Regulation section 1.999-2T(b).

Reverse hybrid splitter arrangement. A reverse hybrid splitter arrangement if you pay or accrue foreign income taxes with respect to income of a reverse hybrid. A reverse hybrid is an entity that is a corporation for U.S. Federal income tax purposes but is a fiscally transparent entity (under the principles of Regulation section 1.894-1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

Loss-sharing splitter arrangement. A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group (usable shared loss) but is used instead to offset income of another U.S. combined income group.

U.S. equity hybrid instrument splitter arrangement. A U.S. equity hybrid instrument is a splitter arrangement if payments or accruals on or with respect to this instrument meet all of the following conditions.

1. They give rise to foreign income taxes paid or accrued by the owner of this instrument.
2. They are deductible by the issuer under the laws of a foreign jurisdiction in which the issuer is subject to tax.
3. They do not give rise to income for U.S. Federal income tax purposes.

A U.S. equity hybrid instrument is an instrument that is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for foreign tax purposes, or with respect to which the issuer is otherwise entitled to a deduction for foreign tax purposes for amounts paid or accrued with respect to the instrument.

U.S. debt hybrid instrument splitter arrangement. A U.S. debt hybrid instrument is a splitter arrangement if the issuer of the U.S. debt hybrid instrument pays or accrues foreign income taxes with respect to income in an amount equal to the interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax.
A U.S. debt hybrid instrument is an instrument that is treated as equity for foreign tax purposes but as indebtedness for U.S. Federal income tax purposes.

**Partnership inter-branch payment splitter arrangement.** An allocation of foreign income tax that a partnership pays or accrues with respect to an inter-branch payment as described in Regulation section 1.704-1(b)(4)(viii)(d)(3) (revised as of April 1, 2011) (the inter-branch tax) is a splitter arrangement to the extent the inter-branch payment tax is not allocated to the partners in the same proportion as the distributive shares of income in the creditable foreign tax expenditures (CFTE) category to which the inter-branch payment tax is or would be assigned under Regulation section 1.704-1(b)(4)(viii)(d) without regard to Regulation section 1.704-1(b)(4)(viii)(d)(3).

**Limit on the Credit**

Your foreign tax credit cannot be more than your total U.S. tax liability (Form 1040, line 44) multiplied by a fraction. The numerator of the fraction is your taxable income from sources outside the United States. The denominator is your total taxable income from U.S. and foreign sources.

To determine the limit, you must separate your foreign source income into categories, as discussed under **Separate Limit Income** next. The limit treats all foreign income and expenses in each separate category as a single unit and limits the credit to the U.S. income tax on the taxable income in that category from all sources outside the United States.

**Separate Limit Income**

You must figure the limit on a separate Form 1116 for each of the following categories of income:

- **Passive category income.**
- **General category income.**
- **Section 901(j) income.**
- **Certain income re-sourced by treaty.**
- **Any lump sum distribution from an employer benefit plan for which the special averaging treatment is used to determine your tax.**

In figuring your separate limits, you must combine the income (and losses) in each category from all foreign sources, and then apply the limit.

**Income from controlled foreign corporations.** As a U.S. shareholder, certain income that you receive or accrue from a controlled foreign corporation (CFC) is treated as separate limit income. You are considered a U.S. shareholder in a CFC if you own 10% or more of the total voting power of all classes of the corporation’s voting stock.

In most cases, except for certain passive income categories, if the CFC is treated as a separate limit income, you must combine the income (and losses) in each category from all foreign sources, and then apply the limit.

**Passive income.** Except as described earlier under **Income from controlled foreign corporations** and **Partnership distributive share**, passive income generally includes the following:

- Dividends.
- Interest.
- Rents.
- Royalties.
- Annuities.
- Net gain from the sale of non-income-producing investment property or property that generates passive income.
- Net gain from commodities transactions, except for hedging and active business gains or losses of producers, processors, or dealers of commodities.
- Amounts includible in income under section 1293 of the Internal Revenue Code (relating to certain passive foreign investment companies).

If you receive foreign source distributions from a mutual fund or other regulated investment company that elects to pass through to you the foreign tax credit, in most cases the income is considered passive. The mutual fund will provide you with a Form 1099-DIV or substitute statement showing the amount of foreign taxes it elected to pass through to you.

What is not passive income. Passive income does not include any of the following:

- Gains or losses from the sale of inventory property or property held mainly for sale to customers in the ordinary course of your trade or business.
- Export financing interest.
- High-taxed income.
- Active business rents and royalties.
- Any income that is defined in another separate limit category.

**Export financing interest.** This is interest derived from financing the sale or other disposition of property for use outside the United States if:

- The property is manufactured, produced, grown, or extracted in the United States by you or a related person, and
- 50% or less of the fair market value of the property is due to imports into the United States.

**High-taxed income.** This is passive income subject to foreign taxes that are higher than the highest U.S. tax rate that can be imposed on the income. The high-taxed income and the taxes imposed on it are moved from passive category income into general category income. See Regulations section 1.904-4(c) for more information.

**Specified passive category income.** Specified passive income consists of:

1. Dividends from a DISC (domestic international sales corporation) or former DISC to the extent the dividends are treated as foreign source income, and
2. Distributions from a former FSC (foreign sales corporation) out of earnings and profits that are attributable to:
   a. Foreign trade income, or
   b. Interest and carrying charges derived from a transaction that results in foreign trade income.

**General Category Income**

General category income includes income from sources outside the United States that is not passive category income or does not fall into one of the other separate limit categories discussed later. In most cases, it includes active business income and wages, salaries, and overseas allowances of an individual as an employee. General category income includes high-taxed income that would otherwise be passive income. See High-taxed income, earlier, under What is not passive income.

**Financial services income.** In general, financial services income is treated as general category income if it is derived by a financial services entity. You are a financial services entity if you are predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. Financial services income of a financial services entity includes income derived in the active conduct of a banking, insurance, or similar business. Financial services income of a financial services entity also includes passive income and certain incidental income.

If you qualify as a financial services entity because you treat certain items of income as active financing income under Regulations section 1.904-4(a)(2)(ii)(Y), you must show the type and amount of each item on an attachment to Form 1116.

**Section 901(j) Income**

This is income earned from activities conducted in sanctioned countries. Income derived from each sanctioned country is subject to a separate foreign tax credit limitation. Therefore, you must use a separate Form 1116 for income earned from each such country. See Taxes Imposed By Sanctioned Countries (Section 901(j) Income) under Taxes for Which You Can Only Take an Itemized Deduction, earlier.

**Certain Income Re-Sourced By Treaty**

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

You must compute a separate foreign tax credit limitation for any such income for which you claim benefits under a treaty, using a separate Form 1116 for each amount of re-sourced income from a treaty country. See sections 865(h), 904(d)(6), and 904(h)(10) and the regulations under those sections (including Regulation section 1.904-5(m)(7)) for any grouping rules and exceptions.

See Tax Treaties, later, for further information regarding income re-sourced by treaty.

**Lump-Sum Distribution**

If you receive a foreign source lump-sum distribution (LSD) from a retirement plan, and you figure the tax on it using the special averaging treatment for LSDs, you must make a special computation. Follow the Form 1116 instructions and complete the worksheet in those instructions to determine your foreign tax credit on the LSD.

**Tip**

The special averaging treatment for LSDs is elected by filling Form 4972, Tax on Lump-Sum Distributions.

**Allocation of Foreign Taxes**

Solely for purposes of allocating foreign taxes to separate limit income categories, those separate limit categories include any U.S. source income that is taxed by the foreign country or U.S. possession.

If you paid or accrued foreign income tax for a tax year on income in more than one separate limit income category, allocate the tax to the income category to which the tax specifically relates. If the tax is not specifically related to any one category, you must allocate the tax to each category of income.

You do this by multiplying the foreign income tax related to more than one category by a fraction. The numerator of the fraction is the gross income taxed by the foreign country or U.S. possession. The denominator is the total foreign income tax.

You figure net income by deducting from the gross income in each category and from the total gross income taxed by the foreign country or U.S. possession any expenses, losses, and other deductions definitely related to them under the laws of the foreign country or U.S. possession. If the expenses, losses, and other deductions are not definitely related to a category of income under foreign law, they are apportioned under the principles of the foreign law. If the foreign law does not provide for apportionment, use the principles covered in the U.S. Internal Revenue Code.

**Example.** You paid foreign income taxes of $3,200 to Country A on wages of $80,000 and interest income of $3,000. These were the only items of income on your foreign return. You also have deductions of $4,400 that, under foreign law, are not definitely related to either the wages or interest income. Your total net income is $78,600 ($83,000−$4,400).

Because the foreign tax is not specifically for either item of income, you must allocate the tax between the wages and the interest under the tax laws of Country A. For purposes of this example, assume that the laws of Country A do this in a manner similar to the U.S. Internal Revenue Code. First figure the net income in each category by allocating those expenses that are not definitely related to either category of income.

You figure the expenses allocable to wages (general category income) as follows.

\[
\text{Expenses allocable to wages} = \frac{\text{Net income from wages}}{\text{Total net income}} \times \text{Foreign income tax}
\]

\[
\text{Expenses allocable to wages} = \frac{78,600}{83,000} \times 3,200 = 2,841
\]

The net wages are $75,759 ($80,000 − $4,241).

You figure the expenses allocable to interest (passive category income) as follows.

\[
\text{Expenses allocable to interest} = \frac{\text{Net income from interest}}{\text{Total net income}} \times \text{Foreign income tax}
\]

\[
\text{Expenses allocable to interest} = \frac{2,841}{3,084} \times 3,000 = 2,841
\]

Then, to figure the foreign tax on the wages, you multiply the total foreign income tax by the following fraction.

\[
\text{Foreign income tax on wages} = \frac{\text{Net income from wages}}{\text{Total net income}} \times \text{Foreign income tax}
\]

\[
\text{Foreign income tax on wages} = \frac{78,600}{83,000} \times 3,200 = 2,841
\]

**Foreign Taxes From a Partnership or an S Corporation**

If foreign taxes were paid or accrued on your behalf by a partnership or an S corporation, you will figure your credit using certain information from the Schedule K-1 you received from the partnership or S corporation. If you received a 2013 Schedule K-1 from a partnership or an S corporation that includes foreign tax information, see your Form 1116 instructions for how to report that information.

**Figuring the Limit**

Before you can determine the limit on your credit, you must first figure your total taxable income from all sources before the deduction for personal exemptions. This is the amount shown on line 41 of Form 1040 or line 39 of Form 1040NR. Then for each category of income, you must figure your taxable income from sources outside the United States.

Before you can figure your taxable income in each category from sources outside the United States, you must first determine whether your gross income in each category is from U.S. sources or foreign sources. Some of the general rules for figuring the source of income are outlined in Table 2.

See Determining the Source of Compensation for Labor or Personal Services and Determining the Source of Income From the Sales or Exchanges of Certain Personal Property, later, for a more detailed discussion on determining the source of these types of income.

**Determining the Source of Income from U.S. Possessions.** In most cases, the rules for determining whether income is from sources in a U.S. possession are the same as those for determining whether income is from U.S. sources.
Table 2. Source of Income

<table>
<thead>
<tr>
<th>Item of Income</th>
<th>Factor Determining Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, wages, other compensation</td>
<td>Where services performed</td>
</tr>
<tr>
<td>Business income:</td>
<td></td>
</tr>
<tr>
<td>Personal services</td>
<td>Where services performed</td>
</tr>
<tr>
<td>Sale of inventory—purchased</td>
<td>Where sold</td>
</tr>
<tr>
<td>Sale of inventory—produced</td>
<td>Allocation</td>
</tr>
<tr>
<td>Interest</td>
<td>Residence of payer</td>
</tr>
<tr>
<td>Dividends</td>
<td>Whether a U.S. or foreign corporation*</td>
</tr>
<tr>
<td>Rents</td>
<td>Location of property</td>
</tr>
<tr>
<td>Royalties:</td>
<td></td>
</tr>
<tr>
<td>Natural resources</td>
<td>Location of property</td>
</tr>
<tr>
<td>Patent, copyrights, etc.</td>
<td>Where property is used</td>
</tr>
<tr>
<td>Sale of real property</td>
<td>Location of property</td>
</tr>
<tr>
<td>Sale of personal property</td>
<td>Seller’s tax home (but see Determining the Source of Income From the Sales or Exchanges of Certain Personal Property, later, for exceptions)</td>
</tr>
<tr>
<td>Pension distributions attributable to contributions</td>
<td>Where services were performed that earned the pension</td>
</tr>
<tr>
<td>Investment earnings on pension contributions</td>
<td>Location of pension trust</td>
</tr>
<tr>
<td>Sale of natural resources</td>
<td>Allocation based on fair market value of product at export terminal. For more information, see Regulations section 1.863-1(b).</td>
</tr>
</tbody>
</table>

* Exceptions include:
  a) Dividends paid by a U.S. corporation are foreign source if the corporation elects the American Samoa Economic Development Credit,
  b) Part of a dividend paid by a foreign corporation is U.S. source if at least 25% of the corporation’s gross income is effectively connected with a U.S. trade or business for the 3 tax years before the year in which the dividends are declared.

However, exceptions do apply. See Pub. 570 for more information.

Determining the Source of Compensation for Labor or Personal Services

If you are an employee and receive compensation for labor or personal services performed both inside and outside the United States, special rules apply in determining the source of the compensation. Compensation (other than certain fringe benefits) is sourced on a time basis. Certain fringe benefits (such as housing and education) are sourced on a geographical basis.

Or, you may be permitted to use an alternative basis to determine the source of compensation. See Alternative basis, later.

If you are self-employed, you determine the source of compensation for labor or personal services from self-employment on the basis that most correctly reflects the proper source of that income under the facts and circumstances of your particular case. In many cases, the facts and circumstances will call for an apportionment on a time basis as explained next.

**Time basis.** Use a time basis to figure your foreign source compensation (other than the fringe benefits discussed later). Do this by multiplying your total compensation (other than the fringe benefits discussed later) by the following fraction:

\[
\text{Number of days you performed services in the foreign country during the year} \div \text{Total number of days you performed services during the year}
\]

You can use a unit of time less than a day in the above fraction, if appropriate. The time period for which the compensation is made does not have to be a year. Instead, you can use another distinct, separate, and continuous time period if you can establish to the satisfaction of the IRS that this other period is more appropriate.

**Example 1.** Christina Brooks, a U.S. citizen, worked 240 days for a U.S. company during the tax year. She received $90,000 in compensation. None of it was for fringe benefits. Christina performed services in the United States for 60 days and performed services in the United Kingdom for 180 days. Using the time basis for determining the source of compensation, $60,000 ($80,000 × 180/240) is her foreign source income.

**Example 2.** Rob Waters, a U.S. citizen, is employed by a U.S. corporation. His principal place of work is in the United States. His annual salary is $100,000. None of it is for fringe benefits. During the first quarter of the year he worked entirely within the United States. On April 1, Rob was transferred to Singapore for the remainder of the year. Rob is able to establish that the first quarter of the year and the last three quarters of the year are two separate, distinct, and continuous periods of time. Accordingly, $25,000 of Rob’s annual salary is attributable to the first quarter of the year (.25 × $100,000). All of it is U.S. source income because he worked entirely within the United States during that quarter. The remaining $75,000 is attributable to the last three quarters of the year. During those quarters, he worked 150 days in Singapore and 30 days in the United States. His periodic performance of services in the United States did not result in distinct, separate, and continuous periods of time. Of his $75,000 salary, $62,500 ($75,000 × 150/180) is foreign source income for the year.

**Multi-year compensation.** In most cases, the source of multi-year compensation is determined on a time basis over the period to which the compensation is attributable. Multi-year compensation is compensation that is included in your income in one tax year but that is attributable to a period that includes two or more tax years.

You determine the period to which the compensation is attributable based on the facts and circumstances of your case. For example, an amount of compensation that specifically relates to a period of time that includes several calendar years is attributable to the entire multi-year period.

The amount of compensation treated as from foreign sources is figured by multiplying the total multi-year compensation by a fraction. The numerator of the fraction is the number of days (or unit of time less than a day, if appropriate) that you performed labor or personal services in the foreign country in connection with the project. The denominator of the fraction is the total number of days (or unit of time less than a day, if appropriate) that you performed labor or personal services in the foreign country during the year. The typical fraction is the following:

\[
\text{Number of days you performed services in the foreign country during the year} \div \text{Total number of days you performed services during the year}
\]

The numerator of the fraction is the total number of days (or unit of time less than a day, if appropriate) that you performed labor or personal services in the foreign country during the period to which the compensation is attributable.
personal services in connection with the project.

Geographical basis. Compensation you receive as an employee in the form of the following fringe benefits is sourced on a geographical basis.

- Housing.
- Education.
- Local transportation.
- Tax reimbursement.
- Hazardous or hardship duty pay.
- Moving expense reimbursement.

The amount of fringe benefits must be reasonable and you must substantiate them by adequate records or by sufficient evidence. Table 3 summarizes the factors used for determining the source of these fringe benefits.

**Housing.** The source of a housing fringe benefit is determined based on the location of your principal place of work. A housing fringe benefit includes payments to you or on your behalf (and your family if your family resides with you) only for the following:

- Rent.
- Utilities (except telephone charges).
- Real and personal property insurance.
- Occupancy taxes not deductible under section 164 or 216(a).
- Nonrefundable fees for securing a leasehold.
- Rental of furniture and accessories.
- Household repairs.
- Residential parking.
- Fair rental value of housing provided in kind by your employer.

A housing fringe benefit does not include:

- Deductible interest and taxes (including interest) on taxes of a tenant-stockholder in a cooperative housing corporation.
- The cost of buying property, including principal payments on a mortgage.
- The cost of domestic labor (maids, gardeners, etc.).
- Pay television subscriptions.
- Improvements and other expenses that increase the value or appreciably prolong the life of property.
- Purchased furniture or accessories.
- Depreciation or amortization of property or improvements.
- The value of meals or lodging that you exclude from gross income.
- The value of meals or lodging that you deduct as moving expenses.

**Education.** The source of an education fringe benefit for the education expenses of your dependents is determined based on the location of your principal place of work. An education fringe benefit includes payments only for the following expenses for education at an elementary or secondary school.

- Tuition, fees, academic tutoring, special needs services for a special needs student, books, supplies, and other equipment.
- Room and board and uniforms that are required or provided by the school in connection with enrollment or attendance.

**Local transportation.** The source of a local transportation fringe benefit is determined based on the location of your principal place of work. Your local transportation fringe benefit is the amount that you receive as compensation for your local transportation or that of your spouse or dependents at the location of your principal place of work. The amount treated as a local transportation fringe benefit is limited to actual expenses incurred for local transportation and the fair rental value of any employer-provided vehicle used predominantly by you or your spouse or dependents for local transportation. Actual expenses do not include the cost (including interest) of any vehicle purchased by you or on your behalf.

**Tax reimbursement.** The source of a foreign tax reimbursement fringe benefit is determined based on the location of the jurisdiction that imposed the tax for which you are reimbursed.

**Hazardous or hardship duty pay.** The source of hazardous or hardship duty pay fringe benefit is determined based on the location of the hazardous or hardship duty zone for which the hazardous or hardship duty pay fringe benefit is paid. A hazardous or hardship duty zone is any place in a foreign country which meets either of the following conditions.

- The zone is designated by the Secretary of State as a place where living conditions are extraordinarily difficult, notably unhealthy, or where excessive physical hardships exist, and for which a post differential of 15 percent or more would be provided under section 5925(b) of Title 5 of the U.S. Code to any officer or employee of the U.S. government at that place.
- The zone is where civil insurrection, civil war, terrorism, or wartime conditions threaten physical harm or imminent danger to your health and well-being.

Compensation is treated as a hazardous or hardship duty pay fringe benefit only if your employer provides the hazardous or hardship duty pay fringe benefit only to employees performing labor or personal services in a hazardous or hardship duty zone.

The amount of compensation treated as a hazardous or hardship duty pay fringe benefit cannot exceed the maximum amount that the U.S. government would allow its officers or employees present at that location.

**Moving expense reimbursement.** In most cases, the source of a moving expense reimbursement is based on the location of your new principal place of work. However, the source is determined based on the location of your former principal place of work if you have sufficient evidence that such determination of source is appropriate under the facts and circumstances of your case. Sufficient evidence generally requires an agreement between you and your employer in most cases, or a written statement of company policy, which is reduced to writing before the move and which is entered into or established to induce you or other employees to move to another country. The written statement or agreement must state that your employer will reimburse you for moving expenses that you incur to return to your former principal place of work regardless of whether you continue to work for your employer after returning to that location. It may contain certain conditions upon which the right to reimbursement is determined as long as those conditions set forth standards that are definitely ascertainable and can only be fulfilled prior to, or through completion of, your return move to your former principal place of work.

**Alternative basis.** If you are an employee, you can determine the source of your compensation under an alternative basis if you establish to the satisfaction of the IRS that, under the facts and circumstances of your case, the alternative basis more properly determines the source of your compensation than the time or geographical basis. If you use an alternative basis, you must keep (and have available for inspection) records to document why the alternative basis is more proper than the source of your compensation. Also, if your total compensation from all sources was $250,000 or more, you must check the box on Form 1116, line 1b, and attach a written statement to your tax return that sets forth all of the following:

1. Your name and social security number (written across the top of the statement).
2. The specific compensation income, or the specific fringe benefit, for which you are using the alternative basis.
3. For each item in (2), the alternative basis of allocation of source used.
4. For each item in (2), a computation showing how the alternative allocation was computed, and
5. A comparison of the dollar amount of the U.S. compensation and foreign compensation sourced under both the alternative basis and the time or geographical basis discussed earlier.

**Transportation Income**

Transportation income is income from the use of a vessel or aircraft or for the performance of services directly related to the use of any vessel or aircraft. This is true whether the vessel or aircraft is owned, hired, or leased. The term “vessel or aircraft” includes any container used in connection with a vessel or aircraft.

All income from transportation that begins and ends in the United States is treated as derived from sources in the United States. If the transportation begins or ends in the United States, 50% of the transportation income is treated as derived from sources in the United States.

For transportation income from personal services, 50% of the income is U.S. source income if the transportation is between the United States and a U.S. possession. For nonresident aliens, this only applies to income derived from, or in connection with, an aircraft.
Determining the Source of Income From the Sales or Exchanges of Certain Personal Property

In most cases, if personal property is sold by a U.S. resident, the gain or loss from the sale is treated as U.S. source. If personal property is sold by a nonresident, the gain or loss is treated as foreign source.

This rule does not apply to the sale of inventory, intangible property, or depreciable property, or property sold through a foreign office or fixed place of business. The rules for these types of property are discussed later.

U.S. resident. The term “U.S. resident,” for this purpose, means a U.S. citizen or resident alien who does not have a tax home in a foreign country. The term also includes a nonresident alien who has a tax home in the United States. In most cases, your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you are permanently or indefinitely engaged to work as an employee or self-employed individual. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work.

Nonresident. A nonresident is any person who is not a U.S. resident. U.S. citizens and resident aliens with a foreign tax home will be treated as nonresidents for a sale of personal property only if an income tax of at least 10% of the gain on the sale is paid to a foreign country.

This rule also applies to losses if the foreign country would have imposed a 10% or higher marginal tax rate had the sale resulted in a gain.

Inventory. Income from the sale of inventory that you purchased is sourced where the property is sold. In most cases, this is where title to the property passes to the buyer.

Income from the sale of inventory that you produced in the United States and sold outside the United States (or vice versa) is sourced based on an allocation. For information on making the allocation, see Regulations section 1.683-3.

Intangibles. Intangibles include patents, copyrights, trademarks, and goodwill. The gain from the sale of amortizable or depreciable intangible property, up to the previously allowable amortization or depreciation deductions, is sourced in the same way as the original deductions were sourced. This is the same as the source rule for gain from the sale of depreciable property. See Depreciable property, next, for details on how to apply this rule.

Gain in excess of the amortization or depreciation deduction is sourced in the country where the property is used if the income from the sale is contingent on the productivity, use, or disposition of that property. If the income is not contingent on the productivity, use, or disposition of the property, the income is sourced according to the seller’s tax home as discussed earlier. Payments for goodwill are sourced in the country where the goodwill was generated if the payments are not contingent on the productivity, use, or disposition of the property.

Depreciable property. The gain from the sale of depreciable personal property, up to the amount of the previously allowable depreciation, is sourced in the same way as the original deductions were sourced. Thus, to the extent the previous deductions for depreciation were allocable to U.S. source income, the gain is U.S. source. To the extent the depreciation deductions were allocable to foreign sources, the gain is foreign source income. Gain in excess of the depreciation deductions is sourced the same as inventory.

If personal property is used predominantly in the United States, treat the gain from the sale to the extent allocable to the amount of the allowable depreciation deductions, entirely as U.S. source income.

If the property is used predominantly outside the United States, treat the gain, up to the amount of the depreciation deductions, entirely as foreign source income.

A loss is sourced in the same way as the depreciation deductions were sourced. However, if the property was used predominantly outside the United States, the entire loss reduces foreign source income.

Depreciation includes amortization and any other allowable deduction for a capital expense that is treated as a deductible expense.

Sales through foreign office or fixed place of business. In most cases, income earned by U.S. residents from the sale of personal property through an office or other fixed place of business outside the United States is treated as foreign source income.

The income from the sale is from the business operations located outside the United States, and

At least 10% of the income is paid as tax to the foreign country.

If less than 10% is paid as tax, the income is U.S. source.

This rule also applies to losses if the foreign country would have imposed a 10% or higher marginal tax rate had the sale resulted in a gain.

This rule does not apply to income sourced under the rules for inventory property, depreciable personal property, intangible property (when payments in consideration for the sale are contingent on the productivity, use, or disposition of the property), or goodwill.

Determining Taxable Income From Sources Outside the United States

To figure your taxable income in each category from sources outside the United States, you first allocate to specific classes (kinds) of gross income the expenses, losses, and other deductions (including the deduction for foreign housing costs) that are definitely related to that income.

Definitely related. A deduction is definitely related to a specific class of gross income if it is incurred either:

- As a result of, or incident to, an activity from which that income is derived, or
- In connection with property from which that income is derived.

Classes of gross income. You must determine which of the following classes of gross income your deductions are definitely related to.

- Compensation for services, including wages, salaries, fees, and commissions.
- Gross income from business.
- Gains from dealings in property.
- Interest.
- Rents.
- Royalties.
- Dividends.
- Alimony and separate maintenance.
- Annuities.
- Pensions.
- Income from life insurance and endowment contracts.
- Income from cancelled debts.
- Your share of partnership gross income.
- Income in respect of a decedent.
- Income from an estate or trust.

Exempt income. When you allocate deductions that are definitely related to one or more classes of gross income, you take exempt income into account for the allocation. However, do not take exempt income into account to apportion deductions that are not definitely related to a separate limit category.

Interest expense and state income taxes. You must allocate and apportion your interest expense and state income taxes under the special rules discussed later under Interest expense and State income taxes.

Class of gross income that includes more than one separate limit category. If the class of gross income to which a deduction definitely relates includes either:

- More than one separate limit category, or
- At least one separate limit category and U.S. source income,

you must apportion the definitely related deductions within that class of gross income.

To apportion, you can use any method that reflects a reasonable relationship between the deduction and the income in each separate limit category. One acceptable method for many individuals is based on a comparison of the gross income in a class of income to the gross income in a separate limit income category.

Use the following formula to figure the amount of the definitely related deduction apportioned to the income in the separate limit category:

\[
\text{Gross income in separate limit category} \times \frac{\text{deduction}}{\text{Total gross income in the class}}
\]

Do not take exempt income into account when you apportion the deduction. However, income excluded under the foreign earned income or
foreign housing exclusion is not considered exempt. You must, therefore, apportion deductions to that income.

**Interest expense.** In most cases, you apportion your interest expense on the basis of your assets. However, certain special rules apply. If you have gross foreign source income (including income that is excluded under the foreign earned income exclusion) of $5,000 or less, your interest expense can be allocated entirely to U.S. source income.

**Business interest.** Apportion interest incurred in a trade or business using the asset method based on your business assets.

Under the asset method, you apportion the interest expense to your separate limit categories based on the value of the assets that produced the income. You can value assets at fair market value, the tax book value, or the alternative book value. For more information about the asset method, see Temporary Regulations section 1.861-9T(g).

If you use the tax book value method, you can elect to change to the fair market value method at any time without IRS approval. If you elect to use the fair market value method, you must continue to use that method unless you have IRS approval to change methods.

**Investment interest.** Apportion this interest on the basis of your investment assets.

**Passive activity interest.** Apportion interest incurred in a passive activity on the basis of your passive activity assets.

**Partnership interest.** General partners and limited partners with partnership interests of 10% or more must classify their distributive shares of partnership interest expense under the three categories listed above. They must apportion the interest expense according to the rules for those categories by taking into account their distributive share of partnership gross income or pro rata share of partnership assets. For special rules that may apply, see Regulations section 1.861-9T(e).

Limited partners with partnership interests of less than 10% must directly allocate their distributive shares of partnership interest expense to their distributive shares of partnership gross income. They must apportion the interest expense according to their relative distributive shares of gross foreign source income in each income category and of U.S. source income from the partnership. For special rules that may apply, see Regulations section 1.861-9T(e)(4).

**Home mortgage interest.** This is your deductible home mortgage interest (including points and mortgage insurance premiums) from Schedule A (Form 1040). Apportion it under a gross income method, taking into account all income (including business, passive activity, and investment income), but excluding income that is exempt under the foreign earned income exclusion. This gross income method is based on a comparison of the gross income in a separate limit category with total gross income.

The Instructions for Form 1116 have a worksheet for apportioning your deductible home mortgage interest expense.

For this purpose, however, any qualified home (as defined in Publication 936) that is rented is considered a business asset for the period in which it is rented. You therefore apportion this interest under the rules for passive activity or business interest.

**Example.** You are operating a business as a sole proprietorship. Your business generates only U.S. source income. Your investment portfolio consists of several lesser-than-10% stock investments. You have stocks with an adjusted basis of $100,000. Some of your stocks (with an adjusted basis of $40,000) generate U.S. source income. Your other stocks (with an adjusted basis of $60,000) generate foreign pass­ive income. You own your main home, which is subject to a mortgage of $120,000. Interest on this loan is home mortgage interest. You also have a bank loan in the amount of $40,000. The proceeds from the bank loan were divided equally between your business and your investment portfolio. Your gross income from your business is $50,000. Your investment portfolio generated $4,000 in U.S. source income and $6,000 in foreign source passive income. All of your debts bear interest at the annual rate of 10%.

The interest expense for your business is $2,000. It is apportioned on the basis of the business assets. All of your business assets generate U.S. source income; therefore, they are U.S. assets. This $2,000 is interest expense allocable to U.S. source income.

The interest expense for your investments is also $2,000. It is apportioned on the basis of investment assets. $800 ($40,000/$100,000 × $2,000) of your investment interest is apportioned to U.S. source income and $1,200 ($60,000/$100,000 × $2,000) is apportioned to foreign source passive income.

Your home mortgage interest expense is $12,000. It is apportioned on the basis of all your gross income. Your gross income is $60,000, $54,000 of which is U.S. source income and $6,000 of which is foreign source passive income. Thus, $1,200 ($6,000/$60,000 × $12,000) of the home mortgage interest is apportioned to foreign source passive income.

**State income taxes.** State income taxes (and certain taxes measured by taxable income) are definitely related and allocable to the gross income on which the taxes are imposed. If state income tax is imposed in part on foreign source income, the part of your state tax imposed on the foreign source income is definitely related and allocable to foreign source income.

**Foreign income not exempt from state tax.** If the state does not specifically exempt foreign income from tax, the following rules apply:

- If the total income taxed by the state is greater than the amount of U.S. source income for federal tax purposes, then the state tax is allocable to both U.S. source and foreign source income.
- If the total income taxed by the state is less than or equal to the U.S. source income for federal tax purposes, none of the state tax is allocable to foreign source income.

**Foreign income exempt from state tax.** If state law specifically exempts foreign income from tax, the state taxes are allocable to the U.S. source income.

**Example.** Your total income for federal tax purposes, before deducting state tax, is $100,000. Of this amount, $25,000 is foreign source income and $75,000 is U.S. source income. Your total income for state tax purposes is $90,000, on which you pay state income tax of $6,000. The state does not specifically exempt foreign source income from tax. The total state income of $90,000 is greater than the U.S. source income for federal tax purposes. Therefore, the $6,000 is definitely related and allocable to both U.S. and foreign source income.

Assuming that $15,000 ($90,000 – $75,000) is the foreign source income taxed by the state, $1,000 of state income tax is apportioned to foreign source income, figured as follows:

\[
\frac{15,000}{90,000} \times 6,000 = 1,000
\]

**Deductions not definitely related.** You must apportion your foreign income in each separate limit category a fraction of your other deductions that are not definitely related to a specific class of gross income. If you itemize, these deductions are medical expenses, general sales taxes, and real estate taxes for your home. If you do not itemize, this is your standard deduction. You should also apportion any other deductions that are not definitely related to a specific class of income, including deductions shown on Form 1040, lines 23-35.

The numerator of the fraction is your gross foreign income in the separate limit category, and the denominator is your total gross income from all sources. For this purpose, gross income includes income that is excluded under the foreign earned income provisions but does not include any other exempt income.

**Itemized deduction limit.** If you must reduce the total amount of your itemized deductions on Schedule A (Form 1040), line 29 (or Form 1040NR, Schedule A, line 15), you must reduce each of the itemized deductions that are subject to the reduction by the reduction percentage before you complete Form 1116, lines 2, 3a, and 4a.

**Exception.** You do not need to figure the reduction percentage if the entire amount of your itemized deductions is entered on any one of the following lines of Form 1116: line 2, line 3a, or line 4a. Just enter your reduced itemized deductions on that line.

**Figuring the reduction percentage.** Use the Itemized Deductions Worksheet in your tax return instructions to figure the reduction percentage. Divide the amount on line 9 of the worksheet (the overall reduction) by the amount on line 3 of the worksheet (total itemized deductions subject to the reduction). This is your reduction percentage. Apply this reduction percentage (expressed as a decimal rounded to at least four places) to each itemized deduction that is subject to the reduction to determine the amount to enter on the appropriate line of Form 1116.

**Example.** You are single, file Form 1040, and have an adjusted gross income of...
$280,000. Your itemized deductions subject to the overall reduction (line 3 of the worksheet) total $20,000. $8,000 of these deductions are definitely related to the income on Form 1116. Line 1a. The other $12,000 ($20,000 − $8,000) is for real estate taxes, which are not definitely related.

The amount of the overall reduction on line 9 of the worksheet is $900. To figure the amount of the real estate taxes to include in the total for line 3a of Form 1116, divide the amount on line 9 of the worksheet ($900) by the amount on line 3 of the worksheet ($20,000). This is your reduction percentage (4.5%). You must reduce your $12,000 deduction by $540 (4.5% x $12,000). The reduced deduction of $11,460 ($12,000 − $540) is the amount to enter on line 3a of Form 1116. Make a similar computation to figure the amount of definitely related itemized deductions ($7,640) to enter on line 2.

**Treatment of personal exemptions.** Do not take the deduction for personal exemptions, including exemptions for dependents, in figuring taxable income from sources outside the United States.

### Qualified Dividends

Qualified dividends are the amounts you entered on Form 1040, line 9b, or Form 1040NR, line 10b. If you have any qualified dividends, you may be required to make adjustments to the amount of those qualified dividends before you take them into account on line 1a or line 18 of Form 1116. See Foreign Qualified Dividends and Capital Gains (Losses) in the Form 1116 instructions to determine the adjustments you may be required to make before taking foreign qualified dividends into account on line 1a of Form 1116. See the instructions for line 18 in the Form 1116 instructions to determine the adjustments you may be required to make before taking foreign qualified dividends into account on line 1a of Form 1116. See the instructions for line 18 in the Form 1116 instructions to determine the adjustments you may be required to make before taking foreign qualified dividends into account on line 1a of Form 1116.

### Capital Gains and Losses

If you have capital gains (including any capital gain distributions) or capital losses, you may have to make certain adjustments to those gains or losses before taking them into account on line 1a (gains), line 5 (losses), or line 18 (taxable income before subtracting exemptions) of Form 1116.

**Lines 1a and 5.** If you have foreign source capital gains or losses, you may be required to make certain adjustments to those foreign source capital gains or losses before you take them into account on line 1a or line 5 of Form 1116. Use the instructions under Foreign Qualified Dividends and Capital Gains (Losses) in the Instructions for Form 1116 to determine if you are required to make adjustments. Also use the instructions under Foreign Qualified Dividends and Capital Gains (Losses) in the Instructions for Form 1116 to determine if you can use those instructions to make adjustments or if you must use the instructions in this publication to make adjustments.

If you use the instructions in this publication, see Adjustments to Foreign Source Capital Gains and Losses below to determine the adjustments you must make.

**Line 18 (Form 1116).** If you have U.S. or foreign source capital gains, you may be required to adjust the amount you enter on line 18 of Form 1116. Use the instructions for Line 18 in the Instructions for Form 1116 to determine whether you are required to make an adjustment and to determine the amount of the adjustment.

### Adjustments to Foreign Source Capital Gains and Losses

You may have to make the following adjustments to your foreign source capital gains and losses.

- U.S. capital loss adjustment.
- Capital gain rate differential adjustment.

Before you make these adjustments, you must reduce your net capital gain by the amount of any gain you elected to include in investment income on line 4g of Form 4952, Investment Interest Expense Deduction. Your net capital gain is the excess of your net long-term capital gain for the year over any net short-term capital loss for the year. Foreign source gain you elected to include on line 4g of Form 4952 must be entered directly on line 1a of Form 1116 without adjustment.

**U.S. capital loss adjustment.** You must adjust the amount of your foreign source capital gains to the extent that your foreign source capital gain exceeds the amount of your worldwide capital gain (the “U.S. capital loss adjustment”).

Your “foreign source capital gain” is the amount of your foreign source capital gains in excess of your foreign source capital losses. If your foreign source capital gains do not exceed your foreign source capital losses, you do not have a foreign source capital gain and you do not need to make the U.S. capital loss adjustment. See Capital gain rate differential adjustment, later, for adjustments you must make to your foreign source capital gains or losses.

Your “worldwide capital gain” is the amount of your worldwide (U.S. and foreign) capital gains in excess of your worldwide capital losses. If your worldwide capital gains equal or exceed your worldwide capital losses, your "worldwide capital gain" is zero.

Your U.S. capital loss adjustment is the amount of your foreign source capital gain in excess of your worldwide capital gain. (If the amount of your foreign source capital gains does not exceed the amount of your worldwide capital gain, you do not have a U.S. capital loss adjustment.)

### Example 1.

**Example 1.** Alfie has a $300 foreign source capital gain that is passive category income, a $1,000 foreign source capital gain that is general category income, a $400 foreign source capital loss that is general category income, and a $150 U.S. source capital loss. He figures his net gains and U.S. capital loss adjustment as follows.

- Foreign source capital gain = $900 (($1,000 + $300) − $400)
- Worldwide capital gain = $750 (($1,000 + $300) − ($400 + $150))
- U.S. capital loss adjustment = $150 ($900 − $750)

Alfie must then apportion the U.S. capital loss adjustment ($150) between the passive category income and the general category income based on the amount of net capital gain in each separate category.

- $50 apportioned to passive category income ($150 x $300/$900)
- $100 apportioned to general category income ($150 x $600/$900)

Alfie reduces his $300 net capital gain that is passive category income by $50 and includes the resulting $250 on line 1a of the Form 1116 for the passive category income.

- $100 apportioned to general category income ($150 x $600/$900)

Alfie reduces his $600 of net capital gain that is general category income by $100 and includes the resulting $500 on line 1a of the Form 1116 for the general category income.

### Step 2.

If you apportioned any amount of the total U.S. capital loss adjustment to a separate category with a net capital gain in more than one rate group, you must further apportion the U.S. capital loss adjustment among the rate groups in that separate category (separate category rate groups) that have a net capital gain.

The *rate groups* are the 28% rate group, the 25% rate group, the 20% rate group, the 15% rate group, the 0% rate group, and the short-term rate group. The 28% rate group, the 25% rate group, the 20% rate group, the 15% rate group and the 0% rate group are “long-term” rate groups. Table 4 explains the rate groups.

You must apportion the U.S. capital loss adjustment pro rata based on the amount of net capital gain in each separate category rate group. Your net capital gain in a separate category rate group is the amount of your foreign source capital gains in that separate category in the rate group in excess of your foreign source capital losses in that separate category in the
rate group. If your foreign source capital losses exceed your foreign source capital gains, you have a net capital loss in the separate category rate group.

**Example 2.** Dennis has a $300 U.S. source long-term capital loss. Dennis also has foreign source capital gains and losses in the following categories.

<table>
<thead>
<tr>
<th>Income category</th>
<th>28% rate</th>
<th>15% rate</th>
<th>short-term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passive</td>
<td>$200</td>
<td>($100)</td>
<td>$100</td>
</tr>
<tr>
<td>General</td>
<td>$700</td>
<td>($300)</td>
<td></td>
</tr>
</tbody>
</table>

He figures his U.S. capital loss adjustment as follows.

Dennis’ foreign source capital gain is $600. 
\[ ((200 + 700 + 100) − (100 + 300)) \]
Dennis’ worldwide capital gain is $300. 
\[ ((200 + 700 + 100) − (100 + 300 + 300)) \]
Dennis’ U.S. capital loss adjustment is $300. 
\[ ($600 − $300) \]
Dennis must apportion his $300 U.S. capital loss adjustment between passive category income and general category income based on the amount of net capital gain in each separate category.

Dennis’ net capital gain, passive category income is $200. 
\[ ((100 + 200) − 100) \]
Dennis apportions $100 to passive category income. 
\[ ($300 - 200) \]
Dennis’ net capital gain, general category income is $400. 
\[ ($700 - 300) \]
Dennis apportions $200 to general category income. 
\[ ($300 - 400) \]
Dennis has net capital gain in more than one rate group that is passive category income. Therefore, the $100 apportioned to passive category income must be further apportioned between the short-term rate group and the 28% rate group based on the amount of net capital gain in each rate group.

Dennis apportions $33.33 to the short-term rate group. 
\[ (100 \times 100/300) \]
Dennis apportions $66.67 to the 28% rate group. 
\[ (100 \times 200/300) \]

After the U.S. capital loss adjustment, Dennis has $100 of foreign source 15% capital loss that is passive category income, $66.67 of foreign source short-term capital gain that is passive category income, $133.33 of foreign source 28% gain that is passive category income, and $200 of foreign source 15% capital gain that is general category income, as shown in the following table.

<table>
<thead>
<tr>
<th>Income category</th>
<th>28% rate</th>
<th>15% rate</th>
<th>short-term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passive</td>
<td>$200.00</td>
<td>($100)</td>
<td>$100</td>
</tr>
<tr>
<td>General</td>
<td>$700.00</td>
<td>($300.00)</td>
<td>$200.00</td>
</tr>
<tr>
<td></td>
<td>$133.33</td>
<td>($33.33)</td>
<td>$66.67</td>
</tr>
</tbody>
</table>

**Capital gain rate differential adjustment.** After you have made your U.S. capital loss adjustment, you must make additional adjustments (capital gain rate differential adjustments) to your foreign source capital gains and losses.

You must make adjustments to each separate category rate group that has a net capital gain or loss. See **Step 2** under **U.S. capital loss adjustment**, earlier, for instructions on how to determine whether you have a net capital gain or loss in a separate category rate group.

**How to make the adjustment.** How you make the capital gain rate differential adjustment depends on whether you have a net capital gain or net capital loss in a separate category rate group.

**Net capital gain in a separate category rate group.** If you have a net capital gain in a separate category rate group, you must do the following.

1. First determine the amount of your net capital gain in each separate category rate group that must be adjusted.
2. Then make the capital gain rate differential adjustment. See **Capital gain rate differential adjustment for net capital gains, later.**

**How to determine the amount of net capital gain that must be adjusted.** You must adjust the net capital gain in each separate category long-term rate group that remains after the U.S. capital loss adjustment. You must adjust the entire amount of that remaining net capital gain if you do not have a net long-term capital loss from U.S. sources or you do not have any short-term capital gains. If you have a net long-term capital loss from U.S. sources and you have any short-term capital gains, you only need to adjust a portion of the remaining net capital gain in each separate category long-term rate group. In that case, the portion you must adjust is limited to the portion of the remaining net capital gain in the separate category long-term rate group in excess of the U.S. long-term loss adjustment amount (if any) allocated to that separate category long-term rate group. You have a net long-term capital loss from U.S. sources if your long-term capital losses from U.S. sources exceed your long-term capital gains from U.S. sources.

The U.S. long-term loss adjustment amount is the excess of your net long-term capital loss from U.S. sources over the amount by which you reduced your long-term capital gains from foreign sources under **U.S. capital loss adjustment** earlier. If only one separate category long-term rate group has a net capital gain after the U.S. capital loss adjustment, your U.S. long-term loss adjustment amount is allocated to that separate category long-term rate group. If more than one separate category long-term rate group has a net capital gain after the U.S. capital loss adjustment, you must allocate the U.S. long-term loss adjustment amount among the separate category long-term rate groups proportionate to the amount of the remaining net capital gain in each separate category long-term rate group.

You must adjust the portion of your net capital gain in a separate category long-term rate group in excess of the U.S. long-term loss adjustment amount you allocated to that separate category long-term rate group. See the instructions, later, under **Capital gain rate differential adjustment for net capital gains, later.** The remaining portion of your net capital gain in the separate category long-term rate group must be entered on line 1a of Form 1116 without adjustment.

**Example 3.** Mary has a $200 15% capital loss from U.S. sources, a $50 15% capital gain from U.S. sources, and a $200 short-term capital gain from U.S. sources. Mary also has a $300 28% capital gain and a $150 15% capital gain from foreign sources that are passive category income.

Mary does not have a U.S. capital loss adjustment because her foreign source capital gain ($450) does not exceed her worldwide capital gain ($500).
Mary’s net long-term capital loss from U.S. sources is $150 ($200 – $50). Her U.S. long-term loss adjustment amount is $150 ($150 – $50). Mary allocates the $150 between the 28% rate group and the 15% rate group as follows.

Mary allocates $100 ($150 x $300/$450) to the 28% rate group that is passive category income. Therefore, $200 ($300 – $100) of her $300 28% capital gain must be adjusted before it is included on line 1a. The remaining $100 of 28% capital gain is included on line 1a without adjustment.

Mary allocates $50 ($150 x $150/$450) to the 15% rate group that is passive category income. Therefore, only $100 ($150 – $50) of her $150 15% capital gain must be adjusted before it is included on line 1a. The remaining $50 of 15% capital gain is included on line 1a without adjustment.

**Capital gain rate differential adjustment for net capital gains.** Adjust your net capital gain (or the applicable portion of your net capital gain) in each separate category long-term rate group as follows.

- For each separate category that has a net capital gain in the 0% rate group, do not include the applicable amount on Form 1116.
- For each separate category that has a net capital gain in the 15% rate group, multiply the applicable amount of the net capital gain by 0.3786.
- For each separate category that has a net capital gain in the 20% rate group, multiply the applicable amount of the net capital gain by 0.5051.
- For each separate category that has a net capital gain in the 25% rate group, multiply the applicable amount of the net capital gain by 0.6313.
- For each separate category that has a net capital gain in the 28% rate group, multiply the applicable amount of the foreign source net capital gain by 0.7071.

Add each result to any net capital gain in the same long-term separate category rate group that you were not required to adjust and include the combined amounts on line 1a of the applicable Form 1116.

No adjustment is required if you have a net capital gain in a short-term rate group. Include the amount of net capital gain in any short-term rate group on line 1a of the applicable Form 1116 without adjustment.

**Example 4.** Beth has $200 of capital gains in the 28% rate group that are general category income and no other items of capital gain or loss. Beth must adjust the capital gain before she includes it on line 1a as follows.

$200 x 0.7071 = $141.42

Beth includes $141.42 of capital gain on line 1a of Form 1116 for the general category income.

**Example 5.** The facts are the same as Example 3. Mary includes the following amounts of passive category income on line 1a of Form 1116 for passive category income.

Mary’s net long-term capital gain from U.S. sources is $150 ($200 – $50). Her U.S. long-term loss adjustment amount is $150 ($150 – $50). Mary allocates the $150 between the 28% rate group and the 15% rate group as follows.

Mary allocates $100 ($150 x $300/$450) to the 28% rate group that is passive category income. Therefore, $200 ($300 – $100) of her $300 28% capital gain must be adjusted before it is included on line 1a. The remaining $100 of 28% capital gain is included on line 1a without adjustment.

Mary allocates $50 ($150 x $150/$450) to the 15% rate group that is passive category income. Therefore, only $100 ($150 – $50) of her $150 15% capital gain must be adjusted before it is included on line 1a. The remaining $50 of 15% capital gain is included on line 1a without adjustment.

**Capital gain rate differential adjustment for net capital gains.** Adjust your net capital gain (or the applicable portion of your net capital gain) in each separate category long-term rate group as follows.

- For each separate category that has a net capital gain in the 0% rate group, do not include the applicable amount on Form 1116.
- For each separate category that has a net capital gain in the 15% rate group, multiply the applicable amount of the net capital gain by 0.3786.
- For each separate category that has a net capital gain in the 20% rate group, multiply the applicable amount of the net capital gain by 0.5051.
- For each separate category that has a net capital gain in the 25% rate group, multiply the applicable amount of the net capital gain by 0.6313.
- For each separate category that has a net capital gain in the 28% rate group, multiply the applicable amount of the foreign source net capital gain by 0.7071.

Add each result to any net capital gain in the same long-term separate category rate group that you were not required to adjust and include the combined amounts on line 1a of the applicable Form 1116.

No adjustment is required if you have a net capital gain in a short-term rate group. Include the amount of net capital gain in any short-term rate group on line 1a of the applicable Form 1116 without adjustment.

**Example 6.** The facts are the same as Example 2. After making the U.S. capital loss adjustment, Dennis has the following:

<table>
<thead>
<tr>
<th>Income category</th>
<th>28% rate</th>
<th>15% rate</th>
<th>short-term</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>$133.33</td>
<td>$100</td>
<td>$66.67</td>
</tr>
</tbody>
</table>

Dennis now determines the amount of the remaining net capital gain in each separate category long-term rate group that must be adjusted.

Dennis’ net long-term capital loss from U.S. sources is $300. His U.S. long-term loss adjustment amount is $33.33 ($300 – $266.67). Dennis must allocate this amount between the $133.33 of net capital gain remaining in the 28% rate group that is passive category income and the $200 of net capital gain remaining in the 15% rate group that is general category income.

Dennis allocates $13.33 (($333.33 x 0.3333) of the U.S. long-term loss adjustment to passive category income in the 28% rate group. Therefore, Dennis must adjust $120 ($133.33 – $13.33) of the $133.33 net capital gain remaining in the 28% rate group that is passive category income. Dennis allocates $20 ($33.33 x $200 ÷ $333.33) to the 15% rate group, $98.18 (($120 x 0.7071) + 13.33) of 28% capital gain and $66.67 of short-term capital gain on line 1a of Form 1116 for passive category income.

Dennis allocates $20 ($33.33 x $200 ÷ $333.33) to the 15% rate group for general category income. Therefore, Dennis must adjust $180 ($200 – $20) of the $200 net capital gain remaining in the 15% rate group that is general category income. Dennis allocates $89.18 (($180 x 0.3788) + $20) of 15% capital gain on line 1a of Form 1116 for general category income.

**Net capital loss in a separate category rate group.** If you have a net capital loss in a separate category rate group, you must do the following.

1. First determine the rate group of the capital gain offset by that net capital loss. See How to determine the rate group of the capital gain offset by the net capital loss, next.

2. Then make the capital gain rate differential adjustment. See Capital gain rate differential adjustment for net capital loss, later.

**How to determine the rate group of the capital gain offset by the net capital loss.** Use the following ordering rules to determine the rate group of the capital gain offset by the net capital loss.

Determinations under the following ordering rules are made after you have taken into account any U.S. capital loss adjustment. However, determinations under the following ordering rules do not take into account any capital gain rate differential adjustments that you made to any net capital gain in a separate category rate group.

**Step 1.** Net capital losses from each separate category rate group are netted against net capital gains in the same rate group in other separate categories.

**Step 2.** U.S. source capital losses are netted against U.S. source capital gains in the same rate group.

**Step 3.** Net capital losses from each separate category rate group in excess of the amount netted against foreign source net capital gains in Step 1 are netted against your remaining foreign source net capital gains and your U.S. source net capital gains as follows.

1. First, against U.S. source net capital gains in the same rate group, and

2. Next, against net capital gains in other rate groups (without regard to whether such net capital gains are U.S. or foreign source net capital gains) as follows.

   a. A foreign source net capital loss in the short-term rate group is first netted against any net capital gain in the 28% rate group, then against any net capital gain in the 25% rate group, then against any net capital gain in the 20% rate group, then against any net capital gain in the 15% rate group, and finally to offset capital gain net income in the 0% rate group.

   b. A foreign source net capital loss in the 28% rate group is netted first against any net capital gain in the 25% rate group, then against any net capital gain in the 20% rate group, then against any net capital gain in the 15% rate group, and finally to offset capital gain net income in the 0% rate group.

   c. A foreign source net capital loss in the 20% rate group is netted first against any net capital gain in the 15% rate group, then against any net capital gain in the 0% rate group, then against any net capital gain in the 28% rate group, and finally to offset net capital gain in the 25% rate group.

   d. A foreign source net capital loss in the 15% rate group is netted first against any net capital gain in the 0% rate group, then against any net capital gain in the 28% rate group, and finally to offset net capital gain in the 25% rate group.

The net capital losses in any separate category rate group are treated as coming pro rata from each separate category that contains a net capital loss in that rate group to the extent netted against:

- Net capital gains in any other separate category under Step 1.
- Any U.S. source net capital gain under Step 3(1), or
- Net capital gains in any other rate group under Step 3(2).
Capital gain rate differential adjustment for net capital loss. After you have determined the rate group of the capital gain offset by the net capital loss, you make the capital gain rate differential adjustment by doing the following:

- To the extent a net capital loss in a separate category rate group offsets capital gain in the 0% rate group, multiply the net capital loss by zero.
- To the extent a net capital loss in a separate category rate group offsets capital gain in the 15% rate group, multiply that amount of the net capital loss by 0.3788.
- To the extent a net capital loss in a separate category rate group offsets capital gain in the 20% rate group, multiply that amount of the net capital loss by 0.5051.
- To the extent that a net capital loss in a separate category rate group offsets capital gain in the 25% rate group, multiply that amount of the net capital loss by 0.6313.
- To the extent that a net capital loss in a separate category rate group offsets capital gain in the 28% rate group, multiply that amount of the net capital loss by 0.7071.

Include the results on line 5 of the applicable Form 1116.

No adjustment is required to the extent a net capital loss offsets short-term capital gains. Thus, a net capital loss is included on line 5 of the applicable Form 1116 without adjustment to the extent the net capital loss offsets net capital gain in the short-term rate group.

**Example 2.** The facts are the same as Example 2. Dennis has a $100 foreign source 15% capital loss that is passive category income.

This loss is netted against the $200 foreign source 15% capital gain that is general category income according to Step 1.

Dennis includes $33.33 ($100 × 0.3788) of the capital loss on line 5 of the Form 1116 for general category income.

($100 × 0.3788)

**Example 3.** Dawn has a $20 net capital loss in the 15% rate group that is passive category income, a $40 net capital loss in the 15% rate group that is general category income, a $50 U.S. source net capital gain in the 15% rate group, and a $50 net capital gain in the 28% rate group that is passive category income, as shown in the following table.

<table>
<thead>
<tr>
<th>Income category</th>
<th>28% rate</th>
<th>15% rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Passive</td>
<td>$50</td>
<td>($20)</td>
</tr>
<tr>
<td>Foreign General</td>
<td>($40)</td>
<td></td>
</tr>
<tr>
<td>U.S. Source</td>
<td>$50</td>
<td></td>
</tr>
</tbody>
</table>

Of the total $60 of foreign source net capital losses in the 15% rate group, $50 is treated as offsetting the $50 U.S. source net capital gain in the 15% rate group. (See Step 3(1).)

$16.67 of the $50 is treated as coming from passive category income.

($50 × $20/$60)

$33.33 of the $50 is treated as coming from general category income.

($50 × $40/$60)

The remaining $10 of foreign source net capital losses in the 15% rate group are treated as offsetting net capital gain in the 28% rate group. (See Step 3(2)(c).)

$3.33 is treated as coming from passive category income.

($10 × $20/$60)

$6.67 is treated as coming from general category income.

($10 × $40/$60)

Dawn includes $8.66 of the capital loss in the amount she enters on line 5 of Form 1116 for passive category income.

This is $6.31

($16.67 × 0.3788)

plus $2.35

($3.33 × 0.7071)

Dawn includes $17.35 of capital loss in the amount she enters on line 5 of Form 1116 for general category income.

This is $12.63

($33.33 × 0.3788)

plus $4.72

($6.67 × 0.7071)

Dawn also includes $35.36 ($50 × 0.7071) of capital gain in the amount she enters on line 1a of Form 1116 for passive category income.

Allocation of Foreign and U.S. Losses

You must allocate foreign losses for any taxable year and U.S. losses for any taxable year (to the extent such losses do not exceed the separate limitation incomes for such year) among incomes on a proportionate basis.

**Foreign Losses**

If you have a foreign loss when figuring your taxable income in a separate limit income category, and you have income in one or more of the other separate categories, you must first reduce the income in these other categories by the loss before reducing income from U.S. sources.

**Note.** The amount of your taxable income (or loss) in a separate category is determined after any adjustments you make to your foreign source qualified dividends or your foreign source capital gains (losses). See Qualified Dividends and Adjustments to Foreign Source Capital Gains and Losses, earlier, under Capital Gains and Losses.

**Example.** You have $10,000 of passive category income and incur a loss of $5,000 of general category income. You must use the $5,000 loss to offset $5,000 of passive category income.

How to allocate. You must allocate foreign losses among the separate limit income categories in the same proportion as each category’s income bears to total foreign income.

**Example.** You have a $2,000 loss that is general category income, $3,000 of passive category income, and $2,000 of income re-sourced by treaty. You must allocate the $2,000 loss to the income in the other separate categories. 60% ($3,000/$5,000) of the $2,000 loss (or $1,200) reduces passive category income and 40% ($2,000/$5,000) or $800 reduces the income re-sourced by treaty.

**Loss more than foreign income.** If you have a loss remaining after reducing the income in other separate limit categories, use the remaining loss to reduce U.S. source income. For this purpose, the amount of your U.S. source income is your taxable income from U.S. sources increased by the amount of capital losses from U.S. sources that reduced foreign source capital gains as part of a U.S. capital loss adjustment. See U.S. capital loss adjustment; earlier, under Adjustments to Foreign Source Capital Gains and Losses. When you use a foreign loss to offset U.S. source income, you must recapture the loss as explained later under Recaptrue of Prior Year Overall Foreign Loss Accounts.

**U.S. Losses**

You should allocate any net loss from sources in the United States among the different categories of foreign income after allocating all foreign losses as described earlier, and before any of the adjustments discussed later.

The amount of your net loss from sources in the United States is equal to the excess of (1) your foreign source taxable income in all of your separate categories in the aggregate, after taking into account any adjustments under Qualified Dividends and Adjustments to Foreign Source Capital Gains and Losses, over (2) the amount of taxable income you enter on Form 1116, line 18.

Recapture of Prior Year Overall Foreign Loss Accounts

If you have only losses in your separate limit categories, or if you have a loss remaining after allocating your foreign losses to other separate categories, you have an overall foreign loss. If you use this loss to offset U.S. source income (resulting in a reduction of your U.S. tax liability), you must recapture your loss in each succeeding year in which you have taxable income from foreign sources in the same separate limit category. You must recapture the overall loss regardless of whether you chose to claim the foreign tax credit for the loss year.

You recapture the loss by treating part of your taxable income from foreign sources in a later year as U.S. source income. In addition, if, in a later year, you sell or otherwise dispose of property used in your foreign trade or business, you may have to recognize gain and treat it as U.S. source income, even if the disposition would otherwise be nontaxable. See Dispositions, later. The amount you treat as U.S.
source income reduces the foreign source income, and therefore reduces the foreign tax credit limit. You must establish separate accounts for each type of foreign loss that you sustain. The balances in these accounts are the overall foreign loss subject to recapture. Reduce these balances at the end of each tax year by the loss that you recaptured. You must attach a statement to your Form 1116 to report the balances (if any) in your overall foreign loss accounts.

**Overall foreign loss.** You have an overall foreign loss if your gross income from foreign sources for a tax year is less than the sum of your expenses, losses, or other deductions that you allocated and apportioned to foreign income under the rules explained earlier under *Determining Taxable Income From Sources Outside the United States*. But see *Losses not considered*, later, for exceptions.

**Example.** You are single and have gross divided income of $100,000 from U.S. sources. You also have a greater-than-10% interest in a foreign partnership in which you materially participate. The partnership has a loss for the year, and your distributive share of the loss is $15,000. Your share of the partnership’s gross income is $100,000, and your share of its expenses is $115,000. Your only foreign source income is your share of partnership income, which is general category income. You are a bona fide resident of a foreign country and you elect to exclude your foreign earned income. You exclude the maximum $97,600. You also have itemized deductions of $6,500 that are not definitely related to any item of income.

In figuring your overall foreign loss for general category income for the year, you must allocate a ratable part of the $6,500 in itemized deductions to the foreign source income. You figure the ratable part of the $6,500 that is for foreign source income, based on gross income, as follows:

\[
\text{Ratable part of itemized deductions} = \frac{\text{Foreign gross income} \times \text{itemized deductions}}{\text{Total gross income}}
\]

\[
= \frac{100,000 \times 6,500}{110,000} = \$5,509
\]

Therefore, your overall foreign loss for the year is $6,296 figured as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign gross income</td>
<td>$100,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Foreign earned income exclusion</td>
<td>$97,600</td>
</tr>
<tr>
<td>Allowable definitely related expenses</td>
<td>$2,760</td>
</tr>
<tr>
<td>($2,400/$100,000) \times $150,000</td>
<td>$3,633</td>
</tr>
<tr>
<td>Ratable part of itemized deductions</td>
<td>$5,909</td>
</tr>
<tr>
<td>Overall foreign loss</td>
<td>$6,296</td>
</tr>
</tbody>
</table>

**Losses not considered.** You do not consider the following in figuring an overall foreign loss in a given year:

- Net operating loss deduction.
- Foreign expropriation loss not compensated by insurance or other reimbursement.
- Casually or theft loss not compensated by insurance or other reimbursement.

**Recapture provision.** If you have an overall foreign loss for any tax year and use the loss to offset U.S. source income, part of your foreign source taxable income (in the same separate limit category as the loss) for each succeeding year is treated as U.S. source taxable income. The part that is treated as U.S. source taxable income is the smaller of the following:

1. The total amount of maximum potential recapture in all overall foreign loss accounts. The maximum potential recapture in any account for a category is the lesser of:
   a. The current year taxable income from foreign sources in that category (the amount from Form 1116, line 15, less any adjustment for allocation of foreign losses and U.S. losses for that category, discussed earlier), or
   b. The balance in the overall foreign loss account for that category.

2. 50% (or more, if you choose) of your total taxable income from foreign sources.

If the total foreign income subject to recategorization is the amount described in 1 above, then for each separate category the recapture amount is the maximum potential recapture amount for that category. If the total foreign income subject to recategorization is the amount described in 2 above, then for each separate category the recapture amount is computed by multiplying the total recapture amount by the following fraction:

\[
\text{Maximum potential recapture amount for the overall foreign loss account in the separate category} = \frac{\text{Total amount of maximum potential recapture in all overall foreign loss accounts}}{\text{Total overall foreign loss account for that category}}
\]

**Example.** During 2012 and 2013, you were single and a 20% general partner in a partnership that derived its income from Country X. You also received dividend income from U.S. sources during those years.

For 2012, the partnership had a loss and your share was $20,000, consisting of $120,000 gross income less $140,000 expenses. Your net loss from the partnership was $4,150, after deducting the foreign earned income exclusion and definitely related allowable expenses. This loss is related to general category income. Your U.S. dividend income was $20,000. Your itemized deductions totaled $6,000 and were not definitely related to any item of income. In figuring your taxable income for 2012, you deducted your share of the partnership loss from Country X from your U.S. source income.

During 2013, the partnership had net income from Country X. Your share of the net income was $70,000, consisting of $130,000 gross income less $60,000 expenses. Your net income from the partnership was $17,446, after deducting the foreign earned income exclusion and definitely related allowable expenses. This is general category income. You also received dividend income of $20,000 from U.S. sources. Your itemized deductions were $5,600, which are not definitely related to any item of income. You paid income taxes of $4,000 to Country X on your share of the partnership income.

When figuring your foreign tax credit for 2013, you must find the foreign source taxable income that you must treat as U.S. source income because of the foreign loss recapture provisions. You figure the foreign taxable income that you must recharacterize as follows:

**A. Determination of 2012 Overall Foreign Loss**

1. Partnership loss from Country X ........... $4,150
2. Add: Part of itemized deductions allocable to gross income from Country X
   \[
   \frac{\text{Less: itemized deductions allocable to that income}}{\text{[$130,000/$150,000]}} = \frac{\$6,500}{5,633} = \$1,181
   \]
   General category taxable income loss allocated foreign losses ($11,813 – 0) ......... $11,813
3. Total amount of maximum potential recapture in all foreign loss accounts
   (smaller of (1) or (2)) ........... $9,293

**B. Amount of Recapture for 2013**

1. Balance for general category income foreign loss account ........... $9,293
2. Taxable general category income after allocation of foreign losses—General category income .......... $17,446
   Less: Itemized deductions allocable to that income
   \[
   ([130,000/$150,000] \times \$6,500) = 5,633
   \]
   General category taxable income less allocated foreign losses ($11,813 – 0) ......... $11,813
3. Total amount of maximum potential recapture in all foreign loss accounts
   (smaller of (1) or (2)) ........... $9,293
4. Foreign source net income .......... $17,446
   Less: Itemized deductions allocable to foreign source net income
   \[
   ([30,000/$150,000] \times \$6,500) = 5,633
   \]
   General category taxable income subject to recharacterization .......... $5,807
5. 50% of foreign source taxable income subject to recharacterization .......... $5,907
6. Recapture for 2013 (smaller of
   (3) or (5)) .......... $5,907

The amount of the recapture is shown on line 16, Form 1116.

**Recapturing more overall foreign loss than required.** If you want to make an election or change a prior election to recapture a greater part of the balance of an overall foreign loss account than is required (as discussed earlier), you must attach a statement to your Form 1116. If you change a prior year’s election, you should file Form 1040X.

The statement you attach to Form 1116 must show:

- The percentage and amount of your foreign taxable income that you are treating as U.S. source income, and
- The percentage and amount of the balance (both before and after the recapture) in the overall foreign loss account that you are recapturing.

**Deduction for foreign taxes.** You must recapture part (or all, if applicable) of an overall
foreign loss in tax years in which you deduct, rather than credit, your foreign taxes. You re-
capture the lesser of:
- The balance in the applicable overall for-
eign loss account, or
- The foreign source taxable income of the
same separate limit category that resulted in
the overall foreign loss minus the foreign
taxes imposed on that income.

Dispositions. If you dispose of appreciated trade or business property used predominantly outside the United States, and that property
generates foreign source taxable income of the
same separate limit category that resulted in an
overall foreign loss, the disposition is subject to
the recapture rules. In most cases, you are con-
sidered to recognize foreign source taxable in-
come in the same separate limit category as the
overall foreign loss to the extent of the lesser of:
- The fair market value of the property that is
more than your adjusted basis in the prop-
erty, or
- The remaining amount of the overall for-
eign loss not recaptured in prior years or in
the current year as described earlier under Recapture provision and Recapturing more overall foreign loss than required.

This rule applies to a disposition whether or not you actually recognized gain on the disposition and irrespective of the source (U.S. or foreign) of any gain recognized on the disposition.

In most cases, this rule also applies to a gain on the disposition of stock in a controlled foreign corporation (CFC) if you owned more
than 50% (by vote or value) of the stock right before you disposed of it. See Internal Revenue Code section 904(f)(3)(D) for more information.

All of the foreign source taxable income that you are considered to recognize under these rules is subject to recategorization as U.S. source income in most cases. See Regulation section 1.904-1(f)-2(d).

If you actually recognized foreign source gain in the same separate limit category as the
overall foreign loss on a disposition of property described earlier, you must reduce the foreign source taxable income in that separate limit cat-
 egy by the amount of gain you are required to recharacterize. If you recognized foreign source gain in a different separate limit category than the
overall foreign loss on a disposition of prop-
erty described earlier, you are required to re-
duce your foreign source taxable income in that separate limit category for gain that is consid-
ered foreign source taxable income in the over-
all foreign loss category and subject to rechar-
acterization. If you did not otherwise recognize
 gain on a disposition of property described ear-
erly, you must include in your U.S. source in-
come the foreign source taxable income you are required to recognize and recharacterize.

Predominant use outside United States. Property is used predominantly outside the Uni-
ted States if it was located outside the United
States more than 50% of the time during the
3-year period ending on the date of disposition.
If you used the property fewer than 3 years, count the use during the period it was used in a
trade or business.

Disposition defined. A disposition in-
cludes the following transactions.
- A sale, exchange, distribution, or gift of
property.
- A transfer upon the foreclosure of a secur-
ity interest (but not a mere transfer of title
to a creditor or debtor upon creation or ter-
minal of a security interest).
- An involuntary conversion.
- A contribution to a partnership, trust, or
corporation.
- A transfer at death.
- Any other transfer of property whether or
not gain or loss is normally recognized on
the transfer.

The character of the income (for example, as
ordinary income or capital gain) recognized
solely because of the disposition rules is the
same as if you had sold or exchanged the prop-
erty.

However, a disposition does not include ei-
ther of the following:
- A disposition of property that is not a mate-
rial factor in producing income. (This ex-
ception does not apply to the disposition of
stock in a controlled foreign corporation
(CFC) to which Internal Revenue Code
section 904(f)(3)(D) applies.)
- A transaction in which gross income is not
realized.

Basis adjustment. If gain is recognized on
a disposition solely because of an overall for-
eign loss account balance at the time of the dis-
position, the recipient of the property must in-
crease its basis by the amount of gain deemed
recognized. If the property was transferred by
gift, its basis in the hands of the donor immedi-
ately prior to the gift is increased by the amount
of gain deemed recognized.

Recapture of Separate
Limitation Loss Accounts
If, in a prior tax year, you reduced your foreign
taxable income in the separate limit category by
a pro rata share of a loss from another cate-
gory, you must recharacterize in 2013 all or part
of that income as foreign source taxable income
in 2013 in that loss category. If you have separate limitation loss accounts in the loss category relating to more
than one category and the total balances in those loss accounts exceed the income you receive in 2013 in the loss category, then in-
come in the loss category is recharacterized as income in those other categories in proportion

The part that is treated as foreign source taxable income for the tax year is the smaller of:
- The total balance in your overall domestic loss account in each separate category
(less amounts recaptured in earlier years), or
- 50% of your U.S. source taxable income for the tax year.

You must establish and maintain separate overall domestic loss accounts for each sepa-
rate category in which foreign source income is
offset by the domestic loss. The balance in each overall domestic loss account is the amount of the overall domestic loss subject to
recapture. The recharacterized income is allo-
cated among and increases foreign source in-
come in separate categories in proportion to
the balances of the overall domestic loss accounts for those separate categories.

For more information, see the Instructions
for Form 1116.

Tax Treaties
The United States is a party to tax treaties that are
designed, in part, to prevent double taxation
of the same income by the United States and
the treaty country. Many treaties do this by allowing you to treat U.S. source income as foreign source income. Certain treaties have special rules you must consider when figuring your foreign tax credit if you are a U.S. citizen residing in the treaty country. These rules generally limit the amount of U.S. source income that is treated as foreign source income. The treaties that provide for this type of restriction include those with Australia, Austria, Bangladesh, Belgium, Bulgaria, Canada, Czech Republic, Denmark, Finland, France, Germany, Iceland, Ireland, Israel, Italy, Japan, Luxembourg, Malta, Mexico, the Netherlands, New Zealand, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, and the United Kingdom. There is a Worksheet at the end of this publication to help you figure the additional credit that is allowed by reason of these limited re-sourcing rules. But do not use this worksheet to figure the additional credit under the treaties with Australia and New Zealand. In addition, except as provided in regulations, the worksheet does not apply for tax years beginning after August 10, 2010. The amount of income re-sourced in the separate category, as described under Certain Income Re-Sourced By Treaty, earlier, must be computed in accordance with the applicable treaty provision.

You can get more information by writing to:
Internal Revenue Service
International Section
Philadelphia, PA 19255-0725

You can also contact the United States Tax Attaché at the U.S. Embassies in Beijing, London or Paris, or the U.S. consulate in Frankfurt, as appropriate, for assistance.

Report required. You may have to report certain information with your return if you claim a foreign tax credit under a treaty provision. For example, if a treaty provision allows you to take a foreign tax credit for a specific tax that is not allowed by the Internal Revenue Code, you must report this information with your return. To report the necessary information, use Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).

If you do not report this information, you may have to pay a penalty of $1,000.

You do not have to file Form 8833 if you are claiming the additional foreign tax credit (discussed previously).

**Carryback and Carryover**

If, because of the limit on the credit, you cannot use the full amount of qualified foreign taxes paid or accrued in the tax year, you are allowed a 1-year carryback and then a 10-year carryover of the unused foreign taxes.

This means that you can treat the unused foreign tax of a tax year as though the tax were paid or accrued in your first preceding and 10 succeeding tax years up to the amount of any excess limit in those years. A period of less than 12 months for which you make a return is considered a tax year.

The unused foreign tax in each category is the amount by which the qualified taxes paid or accrued are more than the limit for that category. The excess limit in each category is the amount by which the limit is more than the qualified taxes paid or accrued for that category.

Figure your carrybacks or carryovers separately for each separate limit income category.

The mechanics of the carryback and carryover are illustrated by the following examples.

**Example 1.** All of your foreign income is general category income for 2012 and 2013. The limit on your credit and the qualified foreign taxes paid on the income are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Limit</th>
<th>Tax Paid</th>
<th>Unused Foreign Tax (+) or Excess Limit (−)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$200</td>
<td>$100</td>
<td>−100</td>
</tr>
<tr>
<td>2013</td>
<td>$300</td>
<td>$500</td>
<td>+200</td>
</tr>
</tbody>
</table>

In 2013, you had unused foreign tax of $200 to carry to other years. You are considered to have paid this unused foreign tax first in 2012 (the first preceding tax year) up to the excess limit in that year of $100. You can then carry forward the remaining $100 of unused tax.

**Example 2.** All your foreign income is general category income for 2009 through 2014. In 2009, all of your foreign income was general category income, and you had an unused foreign tax of $200. Because you had no foreign income in 2008, you cannot carry back the unused foreign tax to that year. However, you may be able to carry forward the unused tax to the next 10 years. The limit on your credit and the qualified foreign taxes paid on general category income for 2009–2014 are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Limit</th>
<th>Tax Paid</th>
<th>Unused Foreign Tax (+) or Excess Limit (−)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$600</td>
<td>$800</td>
<td>+200</td>
</tr>
<tr>
<td>2010</td>
<td>$600</td>
<td>$700</td>
<td>+100</td>
</tr>
<tr>
<td>2011</td>
<td>$500</td>
<td>$700</td>
<td>+200</td>
</tr>
<tr>
<td>2012</td>
<td>$550</td>
<td>$400</td>
<td>−150</td>
</tr>
<tr>
<td>2013</td>
<td>$800</td>
<td>$700</td>
<td>−100</td>
</tr>
<tr>
<td>2014</td>
<td>$500</td>
<td>$550</td>
<td>+ 50</td>
</tr>
</tbody>
</table>

You cannot carry the $200 of unused foreign tax from 2009 to 2010 or 2011 because you have no excess limit in any of those years. Therefore, you carry the tax forward to 2012, up to the excess limit of $150. The carryover reduces your excess limit in that year to zero. The remaining unused foreign tax of $50 from 2009 can be carried to 2013. At this point, you have fully absorbed the unused foreign tax from 2009 and can carry it no further. You can also carry forward the unused foreign tax from 2010 and 2011.

Special rules for carryforwards of pre-2007 unused foreign taxes. In most cases, the foreign taxes carried forward are allocated to your post-2006 separate income categories to which those taxes would have been allocated if the taxes were paid or accrued in a tax year beginning after 2006. Alternatively, you can allocate unused foreign taxes in the pre-2007 separate category for passive income to the post-2006 separate category for passive category income, and you can allocate all other unused foreign taxes in the eliminated categories to the post-2006 separate category for general category income.

**Effect of bankruptcy or insolvency.** If your debts are canceled because of bankruptcy or insolvency, you may have to reduce your unused foreign tax carryovers to or from the tax year of the debt cancellation by 33 1/3% for each $1 of canceled debt that you exclude from your gross income. Your bankruptcy estate may have to make this reduction if it has acquired your unused foreign tax carryovers. Also, you may not be allowed to carry back any unused foreign tax to a year before the year in which the bankruptcy case began. For more information, see Reduction of Tax Attributes in Publication 908, Bankruptcy Tax Guide.

**Time Limit on Tax Assessment**

When you carry back an unused foreign tax, the IRS is given additional time to assess any tax resulting from the carryback. An assessment can be made up to the end of one year after the expiration of the statutory period for an assessment relating to the year in which the carryback originated.

**Claim for Refund**

If you have an unused foreign tax that you are carrying back to the first preceding tax year, you should file Form 1040X for that tax year and attach a revised Form 1116.

**Taxes All Credited or All Deducted**

In a given year, you must either claim a credit for all foreign taxes that qualify for the credit or claim a deduction for all of them. This rule is applied with the carryback and carryover procedure, as follows.

- You cannot claim a credit carryback or carryover from a year in which you deducted qualified foreign taxes.
- You cannot deduct unused foreign taxes in any year to which you carry them, even if you deduct qualified foreign taxes actually paid in that year.
- You cannot claim a credit for unused foreign taxes in a year to which you carry them unless you also claim a credit for foreign taxes actually paid or accrued in that year.
- You cannot carry back or carry over any unused foreign taxes to or from a year for which you elect not to be subject to the foreign tax credit limit. See Exemption from Foreign Tax Credit Limit under How To Figure the Credit, earlier.
Unused taxes carried to deduction year. If you carry unused foreign taxes to a year in which you chose to deduct qualified foreign taxes, you must compute a foreign tax credit limit for the deduction year as if you had chosen to credit foreign taxes for that year. If the credit computation results in an excess limit (as defined earlier) for the deduction year, you must treat the unused foreign taxes carried to the deduction year as absorbed in that year. You cannot actually deduct or claim a credit for the unused foreign taxes carried to the deduction year. But, this treatment reduces the amount of unused foreign taxes that you can carry to another year.

Because you cannot deduct or claim a credit for unused foreign taxes treated as absorbed in a deduction year, you will get no tax benefit for them unless you file an amended return to change your choice from deducting the taxes to claiming the credit. You have 10 years from the regular due date of the return for the deduction year to make this change. See Changing Your Choice under Choosing To Take Credit or Deduction, earlier.

Example. In 2013, you paid foreign taxes of $600 on general category income. You have a foreign tax credit carryover of $200 from the current tax year (2013) to which you chose to deduct qualified foreign taxes. You are not allowed a deduction for any part of the unused foreign tax carryover of $200 from the current tax year. However, you must treat the unused foreign taxes carried to the deduction year as absorbed in that year. You cannot actually deduct or claim a credit for the unused foreign taxes carried to the deduction year. But, this treatment reduces the amount of unused foreign taxes that you can carry to another year.

If you choose to deduct your foreign taxes in 2013, you would be allowed a credit of $700, consisting of $600 paid in 2013 and $100 of the $200 carried over from 2012. You will have a credit carryover to 2014 of $100, which is your unused 2012 foreign tax credit carryover. If you choose to deduct your foreign taxes in 2013, your deduction will be limited to $600, which is the amount of taxes paid in 2013. You are not allowed a deduction for any part of the carryover from 2012. However, you must treat $100 of the credit carryover as used in 2013, because you have an unused credit limit of $100 ($700 limit minus $600 of foreign taxes paid in 2013). This reduces your carryover to later years.

If you claimed the deduction for 2013 and later decided you wanted to receive a benefit for that $100 part of the 2012 carryover, you could change the choice of a deduction for 2013. You would have to claim a credit for those taxes by filing an amended return for 2013 within the time allowed.

Married Couples

For a tax year in which you and your spouse file a joint return, you must figure the unused foreign tax or excess limit in each separate category on the basis of your combined income, deductions, taxes, and credits.

For a tax year in which you and your spouse file separate returns, you figure the unused foreign tax or excess limit by using only your own separate income, deductions, taxes, and credits. However, if you file a joint return for any other year involved in figuring a carryback or carryover of unused foreign tax to the current tax year, you will need to make an allocation, as explained under Allocations Between Spouses, later.

Figure A. Allocation Between Spouses

(You and your spouse file separate returns for the current tax year (2013), to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return.

Figure A. Allocation Between Spouses

You and your spouse file separate returns for the current tax year (2013), to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return.

You and your spouse file separate returns for the current tax year (2013), to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return.

You and your spouse file a joint return for the current tax year (2013), to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return.

Continuous use of joint return. If you and your spouse file a joint return for the current tax year, and file joint returns for each of the other tax years involved in figuring the carryback or carryover of unused foreign tax to the current tax year, you figure the joint carryback or carryover to the current tax year using the joint unused foreign tax and the joint excess limits.

Joint and separate returns in different years. If you and your spouse file a joint return for the current tax year, but file separate returns for all the other tax years involved in figuring the carryback or carryover of the unused foreign tax to the current tax year, your separate carrybacks or carryovers will be a joint carryback or carryover to the current tax year.

In other cases in which you and your spouse file joint returns for some years and separate returns for other years, you must make the allocation described in Allocations Between Spouses.

Allocations Between Spouses

You may have to allocate an unused foreign tax or excess limit for a tax year in which you and your spouse filed a joint return. This allocation is needed in the following three situations.

1. You and your spouse file separate returns for the current tax year, to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return.

2. You and your spouse file separate returns for the current tax year, to which you carry an unused foreign tax from a tax year for which you and your spouse filed separate returns, but through a tax year for which you and your spouse filed a joint return.

3. You and your spouse file a joint return for the current tax year, to which you carry an unused foreign tax from a tax year for which you and your spouse filed a joint return, but through a tax year for which you and your spouse filed separate returns.

These three situations are illustrated in Figure A. In each of the situations, 2013 is the current year.

Method of allocation. For a tax year in which you must allocate the unused foreign tax or the excess limit for your separate income categories between you and your spouse, you must take the following steps.

1. Figure a percentage for each separate income category by dividing the taxable income of each spouse from sources outside the United States in that category by the joint taxable income from sources outside the United States in that category. Then, apply each percentage to its category's joint foreign tax credit limit to find the part of the limit allocated to each spouse.

2. Figure the part of the unused foreign tax, or of the excess limit, for each separate income category allocable to each spouse. You do this by comparing the allocated limit (figured in (1)) with the foreign taxes paid or accrued by each spouse on income in that category. If the foreign taxes you paid or accrued for that category are more than your part of its limit, you have an unused foreign tax. If, however, your part of that limit is more than the foreign taxes you paid or accrued, you have an excess limit for that category.
Allocation of the carryback and carryover. The mechanics of the carryback and carryover, when allocations between spouses are needed, are illustrated by the following example.

Example. H and W filed joint returns for 2009, 2011, and 2012, and separate returns for 2010 and 2013. Neither H nor W had any unused foreign tax or excess limit for any year before 2009. For the tax years involved, the income, unused foreign tax, excess limits, and carrybacks and carryovers are general category income and are shown in Table 5.

<table>
<thead>
<tr>
<th>Tax year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return</td>
<td>Joint</td>
<td>Separate</td>
<td>Joint</td>
<td>Separate</td>
<td></td>
</tr>
<tr>
<td>H's unused foreign tax to be carried back or over, or excess limit* (enclosed in parentheses)</td>
<td>$50</td>
<td>$25</td>
<td>($65)</td>
<td>$104</td>
<td>($50)</td>
</tr>
<tr>
<td>W's unused foreign tax to be carried back or over, or excess limit* (enclosed in parentheses)</td>
<td>$30</td>
<td>($20)</td>
<td>($20)</td>
<td>$69</td>
<td>($10)</td>
</tr>
<tr>
<td>Carryover absorbed:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>W's from 2009</td>
<td>—</td>
<td>20W</td>
<td>10W</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>H's from 2009</td>
<td>—</td>
<td>—</td>
<td>50H</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>H's from 2010</td>
<td>—</td>
<td>—</td>
<td>15H</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>H's from 2011</td>
<td>—</td>
<td>—</td>
<td>10W</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>W's from 2012</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>10W</td>
<td>—</td>
</tr>
<tr>
<td>W's from 2013</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>50H</td>
</tr>
<tr>
<td>W = Absorbed by W's excess limit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H = Absorbed by H's excess limit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* General category income only

H's separate unused foreign tax from 2010 ($25) is partly absorbed by his remaining excess limit in 2011, and then fully absorbed by W's remaining part of the joint excess limit for 2011 ($10). H's allocated part of the unused foreign tax from 2009 ($50) is fully absorbed by his allocated part of the joint excess limit ($55) for 2011.

H's separate unused foreign tax from 2010 ($25) is partly absorbed (up to $15) by his remaining excess limit in 2011, and then fully absorbed by W's remaining part of the joint excess limit for 2011 ($10). Each spouse's excess limit on the 2011 joint return is reduced by:

1. Each spouse's carryover from earlier years. (W's carryover of $10 from 2009 and H's carryovers of $50 from 2009 and $15 from 2010.)
2. The other spouse's carryover. (H's carryover of $10 from 2010 is absorbed by W's remaining excess limit.)

W's allocated part of the unused foreign tax of $69 from 2012 is partly absorbed by his excess limit in 2013 ($10), and the remaining $59 will be a carryover to general category income for 2014 and the following 8 years unless absorbed sooner. H's allocated part of the unused foreign tax of $104 from 2012 is partly absorbed by his excess limit in 2013 ($50), and the remaining $54 will be a carryover to 2014 and the following 8 years unless absorbed sooner.

Joint Return Filed in a Deduction Year

When you file a joint return in a deduction year, and carry unused foreign tax through that year from the prior year in which you and your spouse filed separate returns, the amount absorbed in the deduction year is the unused foreign tax of each spouse deemed paid or accrued in the deduction year up to the amount of that spouse's excess limit in that year. You cannot reduce either spouse's excess limit in the deduction year by the other's unused foreign taxes in that year.

How To Claim the Credit

You must file Form 1116 to claim the foreign tax credit unless you meet one of the following exceptions.

Exceptions. If you meet the requirements discussed under Exemption from foreign tax credit limit, earlier, and choose to be exempt from the foreign tax credit, do not file Form 1116. Instead, enter your foreign taxes directly on Form 1040, line 47, or Form 1040NR, line 45.

If you are a shareholder of a controlled foreign corporation and chose to be taxed at corporate rates on the income you must include in gross income from that corporation, use Form 1118 to claim the credit. See Controlled foreign corporation shareholder under You Must Have Paid or Accrued the Tax, earlier.

Form 1116

You must file a Form 1116 with your U.S. income tax return, Form 1040 or Form 1040NR. You must file a separate Form 1116 for each of the following categories of income for which you claim a foreign tax credit.

- Passive category income.
- General category income.
- Section 901(j) income.
- Income re-sourced by treaty.
- Lump-sum distributions.

A Form 1116 consists of four parts.

1. Part I—Taxable Income or Loss From Sources Outside the United States (for Category Checked Above). Enter the gross amounts of your foreign or possession source income in the separate limit category for which you are completing the form. Do not include income you excluded on Form 2555 or Form 2555-EZ. From these, subtract the deductions that are definitely related to the separate limit income, and a ratable share of the deductions not definitely related to that income. If, in a separate limit category, you received income from more than one foreign country or U.S. possession, complete a separate column for each. You do not need to report income passed through from a regulated investment company (RIC) on a country by country basis. Aggregate all income passed through from a RIC in a single column in Part I. Enter “RIC” on line g of Part I.

2. Part II—Foreign Taxes Paid or Accrued. This part shows the foreign taxes you paid or accrued on the income in the separate limit category in foreign currency and U.S. dollars. If you paid (or accrued) foreign tax to more than one foreign country or U.S. possession, complete a separate line for each. If you receive income passed through from a RIC, aggregate all foreign taxes paid or accrued on that income on a single line in Part II.

3. Part III—Figuring the Credit. You use this part to figure the foreign tax credit that is allowable.

4. Part IV—Summary of Credits From Separate Parts. You use this part on one Form 1116 (the one with the largest amount entered on line 22) to summarize the foreign tax credits figured on separate Forms 1116.

Records To Keep

You should keep the following records in case you are later asked to verify the taxes shown on your Form 1116, Form 1040, or Form 1040NR. You do not have to attach these records to your Form 1040 or Form 1040NR.

- A receipt for each foreign tax payment.
- The foreign tax return if you claim a credit for taxes accrued.
- Any payee statement (such as Form 1099-DIV or Form 1099-INT) showing foreign taxes reported to you.

The receipt or return you keep as proof should be either the original, a duplicate original, or a duly certified or authenticated copy. If the receipt or return is in a foreign language, you also should have a certified translation of it. Revenue Ruling 67-308 in Cumulative Bulletin 1967-2 discusses in detail the requirements of the certified translation. Issues of the Cumulative Bulletin are available in most IRS offices and you are welcome to read them there.

Simple Example — Filled-In Form 1116

Betsy Wilson is single, under 65, and is a U.S. citizen. She earned $45,000 working as a night
Part III—Figuring the Credit

Betsy elects to be exempt from the foreign tax credit limit because her only foreign taxable income is passive income (dividend of $620) and the amount of taxes paid ($93) is not more than $300. To claim the $93 as a credit, Betsy enters $93 on Form 1040, line 47. (She can claim her total taxes paid of $93 because it is less than her "regular tax," shown on Form 1040, line 44.) She does not file Form 1116. However, she cannot carry any unused foreign taxes to this tax year.

If Betsy does not elect to be exempt from the foreign tax credit limit, she will need to complete a Form 1116 as follows.

Betsy fills in her name and social security number, and checks the box for passive category income.

Part IV—Summary of Credits From Separate Parts III

Because this is the only Form 1116 that Betsy must complete, she does not need to fill in lines 23 through 27 of Part IV.

Comprehensive Example — Filled-In Form 1116

Robert Smith, a U.S. citizen, is a salesman who lived and worked in Country X for all of 2013, except for one week he spent in the United States on business. He is single and under 65. He is a cash-basis taxpayer who uses the calendar year as his tax year.

During the year, Robert received income from sources within Country X and the United States.

Income from United States. Robert received wages of $2,400 for services performed during the one week in the United States. He also received dividend income of $3,000 from sources within the United States. None of the dividends are qualified dividends.

Income from Country X. Robert received the following income from Country X during the year and paid tax on the income to Country X on December 31. The conversion rate throughout the year was 2 pesos to each U.S. dollar (2:1).

Foreign earned income. Robert is a bona fide resident of Country X and figures his allowable exclusion of foreign earned income on Form 2555, Foreign Earned Income (not illustrated). He excludes $97,600 of the wages earned in Country X.

Robert must prorate the business expenses related to the wages earned in Country X between the wages he includes on his U.S. tax return and the amount he excludes as foreign earned income. He cannot deduct the part of the expenses related to the income that he excludes. He figures his allowable expenses (related to the wages earned in Country X) as follows:

\[
\frac{32,500}{30,000} \times 2,400 = 2,600
\]

His employee business expense deduction is $742. This is the difference between his business expenses of $1,600 ($600 + $1,000 from U.S. business trip) and the 2%-of-adjusted-gross-income limit ($858).

Forms 1116

Robert must use two Forms 1116 to figure his allowable foreign tax credit. On one Form 1116, he will mark the block to the left of General category income, and figure his foreign tax credit on the wages of $32,500 (Country X wages minus excluded wages). On the other Form 1116, he will mark the block to the left of Passive category income, and figure his foreign tax credit on his interest income of $1,000 and dividend income of $4,000.

Under the later discussions for each part on the Form 1116, Robert's computations are explained for each Form 1116 that must be completed. Both Forms 1116 are illustrated near the end of this publication.

Computation of Taxable Income

Before making any entries on Form 1116, Robert must figure his taxable income on Form 1040.

His taxable income is $30,397 figured as follows:

<table>
<thead>
<tr>
<th>Gross Income</th>
<th>Less:</th>
<th>Total (Adjusted gross income)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages (Country X)</td>
<td>$32,500</td>
<td>$32,500</td>
</tr>
<tr>
<td>Interest income (Country X)</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Dividend income (U.S.)</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Dividend income (Country X)</td>
<td>4,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>

| Less: Total Itemized Deductions | $8,603 | |
| Taxable income before the personal exemption | $34,297 | |
| Less: Personal Exemption | 3,900 | |
| Taxable Income | $30,397 | |

On each Form 1116, Robert enters $34,297 (his taxable income before the personal exemption) on line 18 of Part III.
Part I—Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)

In figuring the limit on both Forms 1116, Robert must separately determine his taxable income from Country X (Form 1116, line 7).

Form 1116—General category income. On this Form 1116, Robert figures his taxable income from Country X for general category income only. He does not include his passive category income of interest and dividends.

**Line 1a.** Robert enters the foreign wages after exclusion of $32,500 on line 1a.

**Line 2.** The unreimbursed employee business expenses related to these foreign source wages included in income are $600, as shown earlier. Robert must determine which part of the 2%-of-adjusted-gross-income limit ($858) is allocable to these employee business expenses. He figures this as follows:

\[
\frac{600}{1,600} = 0.375
\]

The unreimbursed employee business expenses related to these foreign source wages are $278 ($600 − $322). He enters $278 on line 2. He attaches this explanation to his Form 1116 that he files with his tax return.

**Line 3a–g.** Robert enters $1,500 on line 3a. This is his real estate tax, which is not definitely related to income from any source. Robert must prorate this itemized deduction by using the ratio of gross income from Country X in general category income (line 3d) to his gross income from all sources (line 3e). For this purpose, gross income from Country X and gross income from all sources include the $97,600 of wages that qualify for the foreign earned income exclusion. He figures the ratable part of deductions, $1,389, as follows and enters it on line 3g.

\[
\frac{130,100}{140,500} \times 1,500 = 1,389
\]

**Line 4a.** Robert apportions his deductible home mortgage interest, $5,900, to general category income as follows:

1. Enter gross foreign source income of the type shown on Form 1116. **Do not enter income excluded on Form 2555**
   \[32,500\]
2. Enter gross income from all sources. **Do not enter income excluded on Form 2555**
   \[42,900\]
3. Divide line 1 by line 2 and enter the result as a decimal
   \[.7576\]
4. Enter deductible home mortgage interest (from lines 10 through 13 of Schedule A (Form 1040))
   \[5,900\]
5. Multiply line 4 by line 3. Enter the result here and on Form 1116, line 4a
   \[4,470\]

Robert enters this amount, $4,470, on line 4a.

**Table 6. Robert’s Schedule Showing Computation of His Carryover**

<table>
<thead>
<tr>
<th>Description</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum credit allowable under limit</td>
<td>$750</td>
<td>$1,200</td>
</tr>
<tr>
<td>Foreign tax paid in tax year</td>
<td>$600</td>
<td>1,550</td>
</tr>
<tr>
<td>Unused foreign tax (+) to be carried over or excess of limit (-) over tax</td>
<td>$150</td>
<td>+$350</td>
</tr>
<tr>
<td>Tax credit carried back from 2012</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>Net excess tax to be carried over to 2013</td>
<td>0</td>
<td>+$350</td>
</tr>
<tr>
<td>Less carrybacks to 2011</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>Amount carried over to 2013</td>
<td>$200</td>
<td></td>
</tr>
</tbody>
</table>

**Line 6.** Robert adds the amounts on lines 2, 3g, and 4a, and enters that total ($6,137) on line 6.

**Line 7.** He subtracts the amount on line 6 from the amount on line 1a to arrive at foreign source taxable income of $26,363 in this category. Robert enters this amount on line 7.

Form 1116—Passive category income. On this Form 1116, Robert determines the taxable income from Country X for passive interest and dividend income.

**Line 1a.** He adds the $1,000 interest income and the $4,000 dividend income from Country X and enters the total ($5,000) on line 1a. None of the dividends are qualified dividends.

**Line 3a–g.** Robert figures the part of his itemized deduction (real estate tax) allocable to passive category income as follows and enters the amount on line 3g.

\[
\frac{5,000}{140,500} \times 1,500 = 53
\]

**Line 4a.** Robert apportions the deductible home mortgage interest to passive category income as follows:

1. Enter gross foreign source income of the type shown on Form 1116. **Do not enter income excluded on Form 2555**
   \[2555\]
2. Enter gross income from all sources. **Do not enter income excluded on Form 2555**
   \[2555\]
3. Divide line 1 by line 2 and enter the result as a decimal
   \[.0206\]
4. Enter deductible home mortgage interest (from lines 10 through 13 of Schedule A (Form 1040))
   \[5,900\]
5. Multiply line 4 by line 3. Enter the result here and on Form 1116, line 4a
   \[888\]

He enters this amount, $688, on line 4a.

**Line 6.** Robert adds the amounts on lines 3g and 4a and enters that total ($741) on line 6.

**Line 7.** He subtracts the amount on line 6 from the amount on line 1a to arrive at foreign source taxable income of $4,259 in this category. Robert enters this amount on line 7.

Part II—Foreign Taxes Paid or Accrued

Robert uses Part II, Form 1116, to report the foreign tax paid or accrued on income from foreign sources.

Form 1116—General category income. On this Form 1116, Robert enters the amount of foreign taxes paid (withheld at source), in foreign currency and in U.S. dollars, on the wages from Country X.

**Form 1116—Passive category income.** On this Form 1116, Robert enters the amount of foreign taxes paid, in foreign currency and in U.S. dollars, on the interest and dividend income.

Part III—Figuring the Credit

Robert figures the amount of foreign tax credit in Part III on each Form 1116.

Form 1116—General category income. On this Form 1116, Robert figures the amount of foreign tax credit allowable for the foreign taxes paid on his wages from Country X.

**Line 10.** He has a carryover of $200 for unused foreign taxes paid in 2012 and enters that amount on line 10. He attaches a schedule showing how he figured his $200 carryover to 2013 after carrying back the unused $350 tax paid in 2012 to 2011. (This schedule is shown in Table 6.) The unused foreign tax in 2012 and the excess limit in 2011 are general category income. The unused foreign tax of $200 is carried over to general category income in 2013.

**Line 12.** On line 12, Robert must reduce the total foreign taxes paid by the amount related to the wages he excludes as foreign earned income. To do this, he multiplies the $32,400 foreign tax he paid on his foreign wages by a fraction. The numerator of the fraction is his foreign earned income exclusion ($97,600) minus a proportionate part of his definitely related business expenses ($2,400 – $600 = $1,800). The denominator of the fraction is his total foreign wages ($130,100) minus his total definitely related business expenses ($2,400).

\[
\frac{32,400}{130,100} \times \frac{97,600 - 1,800}{130,100 - 2,400} = 24,306
\]

He enters the result, $24,306, on line 12.
Line 14. His total foreign taxes available for credit are $8,294 ($200 carryover from 2012 + $8,094 paid in 2013 ($32,400 − $24,306)).


Line 21. By completing the rest of Part III, Robert finds that his maximum credit is $6,537.

Line 22. The foreign tax credit on the general category income is the lesser of the foreign tax available for credit, $8,294, or the maximum credit on line 21, $6,537.

Form 1116—Passive category income. Robert now figures the foreign tax credit allowable for the foreign taxes he paid on his interest and dividend income from Country X.

By completing Part III of Form 1116, he finds that his maximum credit for passive category income on line 21 is $1,056.

The foreign tax credit for passive category income is limited to the amount of tax paid, $500.

Part IV—Summary of Credits From Separate Parts III

Robert summarizes his foreign tax credits for the two types of income on Part IV of the Form 1116 with the largest amount on line 22. He uses the Part IV of Form 1116—General category income.

Robert leaves line 29 blank because he did not participate in or cooperate with an international boycott during the tax year. The allowable foreign tax credit is $7,037 ($500 + $6,537) shown on line 30. He also enters this amount on Form 1040, line 47.

Unused Foreign Taxes

Robert now determines if he has any unused foreign taxes that can be used as a carryback or carryover to other tax years.

General category income. Robert has 2013 unused foreign taxes of $1,757 ($8,294 − $6,537) and $200 of 2012 unused foreign taxes available as a carryover to 2014 and later years. (The foreign taxes related to his foreign earned income exclusion are not available for carryover.) He cannot carry back any part of the 2013 unused taxes to 2012 as shown in Table 6.

Passive category income. Robert has no unused foreign taxes for 2013.
Form 1116  
Department of the Treasury  
Internal Revenue Service  (99)  
Foreign Tax Credit  
(Individual, Estate, or Trust)  
Attach to Form 1040, 1040NR, 1041, or 990-T.  
Information about Form 1116 and its separate instructions is at www.irs.gov/form1116.  

OMB No. 1545-0121  
2013  
Attachment  
Sequence No. 19  

Name: Betsy Wilson  
Identifying number: as shown on page 1 of your tax return  
111-00-1111  

Use a separate Form 1116 for each category of income listed below. See Categories of Income in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.  

**a** Passive category income  
**b** General category income  
**c** Section 901(j) income  
**d** Certain income re-sourced by treaty  

**f** Resident of (name of country) ➤ United States  

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.  

### Part I  Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)  

<table>
<thead>
<tr>
<th>Foreign Country or U.S. Possession</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Total (Add cols. A, B, and C.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1a</strong> Gross income from sources within country shown above and of the type checked above (see instructions):</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>620</td>
<td>1a</td>
<td>620</td>
<td></td>
</tr>
<tr>
<td><strong>b</strong> Check if line 1a is compensation for personal services as an employee, your total compensation from all sources is $250,000 or more, and you used an alternative basis to determine its source (see instructions) ➤</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Deductions and losses (Caution: See instructions):**  

| Expenses definitely related to the income on line 1a (attach statement) | | | |  
| Pro rata share of other deductions not definitely related: | | | |  
| **a** Certain itemized deductions or standard deduction (see instructions) | 6,100 | | |  
| **b** Other deductions (attach statement) | -0- | | |  
| **c** Add lines 3a and 3b | 6,100 | | |  
| **d** Gross foreign source income (see instructions) | 620 | | |  
| **e** Gross income from all sources (see instructions) | 45,620 | | |  
| **f** Divide line 3d by line 3e | .0136 | | |  
| **g** Multiply line 3c by line 3f | 83 | | |  
| **4** Pro rata share of interest expense (see instructions): | | | |  
| **a** Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions) | | | |  
| **b** Other interest expense | | | |  
| **5** Losses from foreign sources | | | |  
| **6** Add lines 6, 3g, 4a, 4b, and 5 | 83 | | |  
| **7** Subtract line 6 from line 1a. Enter the result here and on line 15, page 2 | 537 | | |  

### Part II  Foreign Taxes Paid or Accrued (see instructions)  

<table>
<thead>
<tr>
<th>Country</th>
<th>Credit is claimed for taxes (you must check one)</th>
<th>In foreign currency</th>
<th>In U.S. dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>h</strong> Paid</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>i</strong> Accrued</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>j</strong> Date paid or accrued</td>
<td></td>
<td>(k) Dividends</td>
<td>(l) Rents and royalties</td>
</tr>
<tr>
<td><strong>A</strong> 1099 taxes</td>
<td></td>
<td>93</td>
<td></td>
</tr>
<tr>
<td><strong>B</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>8</strong> Add lines A through C, column (s). Enter the total here and on line 9, page 2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For Paperwork Reduction Act Notice, see instructions.  

Cat. No. 11440U  
Form 1116 (2013)
### Form 1116 (2013) Page 2

**Part III Figuring the Credit**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Enter the amount from line 8. These are your total foreign taxes paid or</td>
<td>93</td>
</tr>
<tr>
<td></td>
<td>accrued for the category of income checked above Part I.</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Carryback or carryover (attach detailed computation)</td>
<td>-0-</td>
</tr>
<tr>
<td>11</td>
<td>Add lines 9 and 10</td>
<td>93</td>
</tr>
<tr>
<td>12</td>
<td>Reduction in foreign taxes (see instructions)</td>
<td>-0-</td>
</tr>
<tr>
<td>13</td>
<td>Taxes reclassified under high tax kickout (see instructions)</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Combine lines 11, 12, and 13. This is the total amount of foreign taxes</td>
<td>93</td>
</tr>
<tr>
<td></td>
<td>available for credit.</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Enter the amount from line 7. This is your taxable income or (loss) from</td>
<td>537</td>
</tr>
<tr>
<td></td>
<td>sources outside the United States (before adjustments) for the category</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of income checked above Part I (see instructions).</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Adjustments to line 15 (see instructions)</td>
<td>-0-</td>
</tr>
<tr>
<td>17</td>
<td>Combine the amounts on lines 15 and 16. This is your net foreign source</td>
<td>537</td>
</tr>
<tr>
<td></td>
<td>taxable income. (If the result is zero or less, you have no foreign tax</td>
<td></td>
</tr>
<tr>
<td></td>
<td>credit for the category of income you checked above Part I. Skip lines</td>
<td></td>
</tr>
<tr>
<td></td>
<td>18 through 22. However, if you are filing more than one Form 1116, you</td>
<td></td>
</tr>
<tr>
<td></td>
<td>must complete line 20.</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td><strong>Individuals:</strong> Enter the amount from Form 1040, line 41, or Form</td>
<td>39,520</td>
</tr>
<tr>
<td></td>
<td>1040NR, line 39. <strong>Estates and trusts:</strong> Enter your taxable income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>without the deduction for your exemption.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Caution:</strong> If you figured your tax using the lower rates on qualified</td>
<td>.0136</td>
</tr>
<tr>
<td></td>
<td>dividends or capital gains, see instructions.</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Divide line 17 by line 18. If line 17 is more than line 18, enter “1”</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td><strong>Individuals:</strong> Enter the amount from Form 1040, line 44. If you are a</td>
<td>4,898</td>
</tr>
<tr>
<td></td>
<td>nonresident alien, enter the amount from Form 1040NR, line 42. **Estates</td>
<td></td>
</tr>
<tr>
<td></td>
<td>and trusts:** Enter the amount from Form 1041, Schedule G, line 1a, or the</td>
<td></td>
</tr>
<tr>
<td></td>
<td>total of Form 990-T, lines 36 and 37.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Caution:</strong> If you are completing line 20 for separate category e (lump-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>sum distributions), see instructions.</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Multiply line 20 by line 19 (maximum amount of credit)</td>
<td>67</td>
</tr>
<tr>
<td>22</td>
<td>Enter the smaller of line 14 or line 21. If this is the only Form 1116 you</td>
<td>67</td>
</tr>
<tr>
<td></td>
<td>are filing, skip lines 23 through 27 and enter this amount on line 28.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Otherwise, complete the appropriate line in Part IV (see instructions).</td>
<td></td>
</tr>
</tbody>
</table>

### Part IV Summary of Credits From Separate Parts III (see instructions)

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Credit for taxes on passive category income</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Credit for taxes on general category income</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Credit for taxes on certain income re-sourced by</td>
<td></td>
</tr>
<tr>
<td></td>
<td>treaty</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Credit for taxes on lump-sum distributions</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>Add lines 23 through 26</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Enter the smaller of line 20 or line 27</td>
<td>67</td>
</tr>
<tr>
<td>29</td>
<td>Reduction of credit for international boycott</td>
<td></td>
</tr>
<tr>
<td></td>
<td>operations. See instructions for line 12</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Subtract line 29 from line 28. This is your</td>
<td>67</td>
</tr>
<tr>
<td></td>
<td>foreign tax credit. Enter here and on Form</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1040, line 47; Form 1040NR, line 45; Form 1041,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Schedule G, line 2a; or Form 990-T, line 40a</td>
<td></td>
</tr>
</tbody>
</table>
Form 1116

Foreign Tax Credit
(Individual, Estate, or Trust)

Attach to Form 1040, 1040NR, 1041, or 990-T.

Information about Form 1116 and its separate instructions is at www.irs.gov/form1116.

Name: Robert Smith

Identifying number: 000-00-0000

Use a separate Form 1116 for each category of income listed below. See Categories of Income in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

- a. Passive category income
- b. General category income
- c. Section 901(j) income
- d. Certain income re-sourced by treaty
- e. Lump-sum distributions
- f. Resident of (name of country) ➤ Country X

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)

<table>
<thead>
<tr>
<th>Foreign Country or U.S. Possession</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Deductions and losses (Caution: See instructions):

2 Expenses definitely related to the income on line 1a (attach statement)...

3 Pro rata share of other deductions not definitely related:
   a. Certain itemized deductions or standard deduction (see instructions)...
   b. Other deductions (attach statement)...
   c. Add lines 3a and 3b...

Part II Foreign Taxes Paid or Accrued (see instructions)

<table>
<thead>
<tr>
<th>Country</th>
<th>In foreign currency</th>
<th>In U.S. dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Taxes withheld at source:</td>
<td>Taxes withheld at source:</td>
</tr>
<tr>
<td></td>
<td>Dividends</td>
<td>Rents and royalties</td>
</tr>
<tr>
<td>A</td>
<td>64,800</td>
<td>32,400</td>
</tr>
<tr>
<td>B</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8 Add lines A through C, column (s). Enter the total here and on line 9, page 2...

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11440U

Form 1116 (2013)
### Part III Figuring the Credit

9. Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>32,400</td>
</tr>
</tbody>
</table>

10. Carryback or carryover (attach detailed computation).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>200</td>
</tr>
</tbody>
</table>

11. Add lines 9 and 10.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>32,600</td>
</tr>
</tbody>
</table>

12. Reduction in foreign taxes (see instructions).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>-24,306</td>
</tr>
</tbody>
</table>

13. Taxes reclassified under high tax kickout (see instructions).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>0</td>
</tr>
</tbody>
</table>

14. Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>8,294</td>
</tr>
</tbody>
</table>

15. Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I. (see instructions).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>26,363</td>
</tr>
</tbody>
</table>

16. Adjustments to line 15 (see instructions).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td>0</td>
</tr>
</tbody>
</table>

17. Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 22. However, if you are filing more than one Form 1116, you must complete line 20.)  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>26,363</td>
</tr>
</tbody>
</table>

18. **Individuals**: Enter the amount from Form 1040, line 41, or Form 1040NR, line 39. **Estates and trusts**: Enter your taxable income without the deduction for your exemption.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td>34,297</td>
</tr>
</tbody>
</table>

**Caution**: If you figured your tax using the lower rates on qualified dividends or capital gains, see instructions.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>0.7687</td>
</tr>
</tbody>
</table>

19. Divide line 17 by line 18. If line 17 is more than line 18, enter “1”.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>8,504</td>
</tr>
</tbody>
</table>

**Individuals**: Enter the amount from Form 1040, line 44. If you are a nonresident alien, enter the amount from Form 1040NR, line 42. **Estates and trusts**: Enter the amount from Form 1041, Schedule G, line 1a, or the total of Form 990-T, lines 36 and 37.  

**Caution**: If you are completing line 20 for separate category e (lump-sum distributions), see instructions.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>6,537</td>
</tr>
</tbody>
</table>

20. Multiply line 20 by line 19 (maximum amount of credit).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>21</td>
<td>6,537</td>
</tr>
</tbody>
</table>

21. Enter the smaller of line 14 or line 21. If this is the only Form 1116 you are filing, skip lines 23 through 27 and enter this amount on line 28. Otherwise, complete the appropriate line in Part IV (see instructions).  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>22</td>
<td>6,537</td>
</tr>
</tbody>
</table>

### Part IV Summary of Credits From Separate Parts III (see instructions)

23. Credit for taxes on passive category income.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>500</td>
</tr>
</tbody>
</table>

24. Credit for taxes on general category income.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>6,557</td>
</tr>
</tbody>
</table>

25. Credit for taxes on certain income re-sourced by treaty.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>7,037</td>
</tr>
</tbody>
</table>

26. Credit for taxes on lump-sum distributions.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>26</td>
<td>7,037</td>
</tr>
</tbody>
</table>

27. Add lines 23 through 26.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>7,037</td>
</tr>
</tbody>
</table>

28. Enter the smaller of line 20 or line 27.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>28</td>
<td>7,037</td>
</tr>
</tbody>
</table>

29. Reduction of credit for international boycott operations. See instructions for line 12.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td>7,037</td>
</tr>
</tbody>
</table>

30. Subtract line 29 from line 28. This is your foreign tax credit. Enter here and on Form 1040, line 47; Form 1040NR, line 45; Form 1041, Schedule G, line 2a; or Form 990-T, line 40a.  

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>7,037</td>
</tr>
</tbody>
</table>
Form 1116

Foreign Tax Credit
(Individual, Estate, or Trust)

Attach to Form 1040, 1040NR, 1041, or 990-T.

Information about Form 1116 and its separate instructions is at www.irs.gov/form1116.

Use a separate Form 1116 for each category of income listed below. See Categories of Income in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

a □ Passive category income
c □ Section 901(j) income
e □ Lump-sum distributions
b □ General category income
d □ Certain income re-sourced by treaty
f Resident of (name of country) ► Country X

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)

<table>
<thead>
<tr>
<th>Foreign Country or U.S. Possession</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Total (Add cols. A, B, and C.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country X</td>
<td></td>
<td></td>
<td></td>
<td>1a 5,000</td>
</tr>
</tbody>
</table>

Deductions and losses (Caution: See instructions):

2 Expenses definitely related to the income on line 1a (attach statement)

3 Pro rata share of other deductions not definitely related:
   a Certain itemized deductions or standard deduction (see instructions)
   b Other deductions (attach statement)
   c Add lines 3a and 3b
   d Gross foreign source income (see instructions)
   e Gross income from all sources (see instructions)
   f Divide line 3d by line 3e
   g Multiply line 3c by line 3f
   h Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions)
   i Other interest expense
   j Losses from foreign sources
   k Add lines 2, 3g, 4a, 4b, and 5

7 Subtract line 6 from line 1a. Enter the result here and on line 15, page 2

Part II Foreign Taxes Paid or Accrued (see instructions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Credit is claimed for taxes (you must check one)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(h) □ Paid (i) □ Accrued</td>
</tr>
<tr>
<td></td>
<td>(j) Date paid or accrued</td>
</tr>
<tr>
<td></td>
<td>(k) Dividends (l) Rents and royalties (m) Interest</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>In foreign currency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign taxes paid or accrued</td>
</tr>
<tr>
<td></td>
<td>In U.S. dollars</td>
</tr>
<tr>
<td></td>
<td>Taxes withheld at source on:</td>
</tr>
<tr>
<td></td>
<td>(p) Other foreign taxes paid or accrued</td>
</tr>
<tr>
<td></td>
<td>Taxes withheld at source on:</td>
</tr>
<tr>
<td></td>
<td>(r) Other foreign taxes paid or accrued</td>
</tr>
<tr>
<td></td>
<td>(a) Total foreign taxes paid or accrued (add cols. (s) through (r))</td>
</tr>
</tbody>
</table>

8 Add lines A through C, column (s). Enter the total here and on line 9, page 2

For Paperwork Reduction Act Notice, see instructions.

Robert Smith 000-00-0000

Country X

Dividends, Interest

5,000 5,000

5,000

0.0356

53

688

741

4,259

500
### Part III Figuring the Credit

<table>
<thead>
<tr>
<th>Step</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I.</td>
<td>500</td>
</tr>
<tr>
<td>10</td>
<td>Carryback or carryover (attach detailed computation).</td>
<td>0</td>
</tr>
<tr>
<td>11</td>
<td>Add lines 9 and 10.</td>
<td>500</td>
</tr>
<tr>
<td>12</td>
<td>Reduction in foreign taxes (see instructions).</td>
<td>-0</td>
</tr>
<tr>
<td>13</td>
<td>Taxes reclassified under high tax kickout (see instructions).</td>
<td>-0</td>
</tr>
<tr>
<td>14</td>
<td>Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit.</td>
<td>500</td>
</tr>
<tr>
<td>15</td>
<td>Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I (see instructions).</td>
<td>4,259</td>
</tr>
<tr>
<td>16</td>
<td>Adjustments to line 15 (see instructions).</td>
<td>-0</td>
</tr>
<tr>
<td>17</td>
<td>Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 22. However, if you are filing more than one Form 1116, you must complete line 20.)</td>
<td>4,259</td>
</tr>
<tr>
<td>18</td>
<td><strong>Individuals:</strong> Enter the amount from Form 1040, line 41, or Form 1040NR, line 39. <strong>Estates and trusts:</strong> Enter your taxable income without the deduction for your exemption.</td>
<td>34,297</td>
</tr>
<tr>
<td></td>
<td><strong>Caution:</strong> If you figured your tax using the lower rates on qualified dividends or capital gains, see instructions.</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Divide line 17 by line 18. If line 17 is more than line 18, enter “1”.</td>
<td>.1242</td>
</tr>
<tr>
<td>20</td>
<td><strong>Individuals:</strong> Enter the amount from Form 1040, line 44. If you are a nonresident alien, enter the amount from Form 1040NR, line 42. <strong>Estates and trusts:</strong> Enter the amount from Form 1041, Schedule G, line 1a, or the total of Form 990-T, lines 36 and 37.</td>
<td>8,504</td>
</tr>
<tr>
<td></td>
<td><strong>Caution:</strong> If you are completing line 20 for separate category e (lump-sum distributions), see instructions.</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Multiply line 20 by line 19 (maximum amount of credit).</td>
<td>1,056</td>
</tr>
<tr>
<td>22</td>
<td>Enter the smaller of line 14 or line 21. If this is the only Form 1116 you are filing, skip lines 23 through 27 and enter this amount on line 28. Otherwise, complete the appropriate line in Part IV (see instructions).</td>
<td>500</td>
</tr>
</tbody>
</table>

### Part IV Summary of Credits From Separate Parts III (see instructions)

<table>
<thead>
<tr>
<th>Step</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Credit for taxes on passive category income</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Credit for taxes on general category income</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Credit for taxes on certain income re-sourced by treaty</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Credit for taxes on lump-sum distributions</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>Add lines 23 through 26</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Enter the smaller of line 20 or line 27</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>Reduction of credit for international boycott operations. See instructions for line 12.</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Subtract line 29 from line 28. This is your foreign tax credit. Enter here and on Form 1040, line 47; Form 1040NR, line 45; Form 1041, Schedule G, line 2a; or Form 990-T, line 40a.</td>
<td></td>
</tr>
</tbody>
</table>
**Worksheet. Additional Foreign Tax Credit on U.S. income**

**Keep for Your Records**

I. U.S. tax on U.S. source income

<table>
<thead>
<tr>
<th>(U.S. source rules)</th>
<th>COL. A</th>
<th>COL. B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Dividends</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Royalties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Capital gain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. a. Gross earned income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. b. Allocable employee business expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. c. Net compensation. Subtract line 5b from line 5a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. a. Gross rent, real property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. b. Direct expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. c. Net rent. Subtract line 6b from line 6a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Add lines 1-5a, 6a and 7 in column A and lines 1-4, 5c, 6c and 7 in column B</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Enter tax from Form 1040 (see instructions)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Enter adjusted gross income (AGI) from line 37, Form 1040</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Divide line 9 by line 10. Enter the result as a decimal. This is the average tax rate on your AGI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Multiply line 11 by line 8 (column B). This is your estimated U.S. tax on your U.S. source income.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

II. Tax at source allowable under treaty

A. Items fully taxable by U.S.

| 13. a. Identify |        |
| 13. b. Multiply line 13a by line 11 |        |

B. Items partly taxable by U.S.

| 14. a. Identify |        |
| 14. b. Treaty rate |        |
| 14. c. Allowable tax at source (Multiply line 14a by line 14b) |        |

C. Identify each item of U.S. source income from Col. A, Step I, on which the U.S. may not, under treaty, tax residents of the other country who are not U.S. citizens

III. Additional credit

| 17. Residence country tax on U.S. source income before foreign tax credit |        |
| 18. Foreign tax credit allowed by residence country for U.S. income tax paid |        |
| 19. Maximum credit. Subtract the greater of line 16 or line 18 from line 12 |        |
| 20. a. Enter the amount from line 17 |        |
| 20. b. Enter the greater of line 16 or line 18 |        |
| 20. c. Subtract line 20b from line 20a |        |
| 21. Additional credit. Enter the smaller of line 19 or line 20c. Add this amount to line 12 of Part III and line 30 of Part IV Form 1116. |        |

* See the discussion on Tax Treaties for information on when you should use this worksheet.
### Worksheet Instructions. Additional Foreign Tax Credit on U.S. Income

**Note.** Complete a separate worksheet for each separate limit income category.

### STEP I
Figure the estimated tax on U.S. source income in the separate limit income category using U.S. rules for determining the source of income.

- **Lines 1-7** Enter the gross amount for each type of income in Column A, and the net amount in Column B.
- **Line 9** Enter the amount from Form 1040, line 44.

### STEP II
Determine the amount of tax that the United States is allowed to collect at source under the treaty on income in the separate limit income category of residents of the other country who are not U.S. citizens. (In most cases, this amount should be claimed, to the extent allowable, as a foreign tax credit on your foreign tax return.)

**PART A** Income in the separate limit income category fully taxable by the United States. In most cases, this includes income from a U.S. trade or business and gains from dispositions of U.S. real property. Identify the type and amount on line 13a.

**PART B** Income in the separate limit income category for which treaty limits U.S. tax at source. This may include dividends, interest, royalties, and certain pensions.

- **Lines 14-15** Identify each type and amount of income. Use the specified treaty rate. (See Publication 901, U.S. Tax Treaties.)

**PART C** Identify the items in the separate limit income category not taxable at source by the United States under the treaty.

### STEP III
Figure the amount of the additional credit for foreign taxes paid or accrued on U.S. source income. The additional credit is limited to the difference between the estimated U.S. tax (Step I) and the greater of the allowable U.S. tax at source (Step II) or the foreign tax credit allowed by the residence country (line 18).

- **Line 17** Enter the amount of the residence country tax on your U.S. source income before reduction for foreign tax credits. If possible, use the fraction of the pre-credit residence country tax which U.S. source taxable income bears to total taxable income. Otherwise, report that fraction of the pre-credit foreign tax which gross U.S. income bears to total gross income for foreign tax purposes.

- **Line 21** This amount may be claimed as a foreign tax credit on Form 1116. First, add this amount to the reduction in foreign taxes on line 12, Part III, and complete Form 1116 according to the instructions. Add this amount as an additional credit to line 30, Part IV, of Form 1116 as well and report that total on your Form 1040. File this worksheet with your Form 1040 as an attachment to Form 1116.
How To Get Tax Help

Whether it’s help with a tax issue, preparing your tax return or a need for a free publication or form, get the help you need the way you want it: online, use a smart phone, call or walk in to an IRS office or volunteer site near you.

Free help with your tax return. You can get free help preparing your return nationwide from IRS-certified volunteers. The Volunteer Income Tax Assistance (VITA) program helps low-to-moderate income, elderly, people with disabilities, and limited English proficient taxpayers. The Tax Counseling for the Elderly (TCE) program helps taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. In addition, some VITA and TCE sites provide taxpayers the opportunity to prepare their own return with help from an IRS-certified volunteer. To find the nearest VITA or TCE site, you can use the VITA Locator Tool on IRS.gov, download the IRS2Go app, or call 1-800-906-9887.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, visit AARP’s website at www.aarp.org/money/taxaide or call 1-888-227-7669. For more information on these programs, go to IRS.gov and enter “VITA” in the search box.

Internet. IRS.gov and IRS2Go are ready when you are — 24 hours a day, 7 days a week.

- Download the free IRS2Go app from the iTunes app store or from Google Play. Use it to check your refund status, order transcripts of your tax returns or tax account, watch the IRS YouTube channel, get IRS news as soon as it’s released to the public, subscribe to filing season updates or daily tax tips, and follow the IRS Twitter news feed, @IRSnews, to get the latest federal tax news, including information about tax law changes and important IRS programs.
- Check the status of your 2013 refund with the Where’s My Refund? application on IRS.gov or download the IRS2Go app and select the Refund Status option. The IRS issues more than 9 out of 10 refunds in less than 21 days. Using these applications, you can start checking on the status of your return within 24 hours after we receive your e-filed return or 4 weeks after you mail a paper return. You will also be given a personalized refund date as soon as the IRS processes your tax return and approves your refund. The IRS updates Where’s My Refund? every 24 hours, usually overnight, so you only need to check once a day.
- Use the Interactive Tax Assistant (ITA) to research your tax questions. No need to wait on the phone or stand in line. The ITA is available 24 hours a day, 7 days a week, and provides you with a variety of tax information related to general filing topics, deductions, credits, and income. When you reach the response screen, you can print the entire interview and the final response for your records. New subject areas are added on a regular basis. Answers not provided through ITA may be found in Tax Topics on IRS.gov which contain general individual and business tax information or by searching the IRS Tax Map, which includes an international subject index. You can use the IRS Tax Map, to search publications and instructions by topic or keyword. The IRS Tax Map integrates forms and publications into one research tool and provides single-point access to tax law information by subject. When the user searches the IRS Tax Map, they will be provided with links to related content in existing IRS publications, forms and instructions, questions and answers, and Tax Topics.
- Coming this filing season, you can immediately view and print for free all 5 types of individual federal tax transcripts (tax returns, tax account, record of account, wage and income statement, and certification of non-filing) using Get Transcript. You can also ask the IRS to mail a return or an account transcript to you. Only the mail option is available by choosing the Tax Records option on the IRS2Go app by selecting Mail Transcript on IRS.gov or by calling 1-800-908-9946. Tax return and tax account transcripts are generally available for the current year and the past three years.
- Determine if you are eligible for the EITC and estimate the amount of the credit with the Earned Income Tax Credit (EITC) Assistant.
- Visit Understanding Your IRS Notice or Letter to get answers to questions about a notice or letter you received from the IRS.
- If you received the First Time Homebuyer Credit, you can use the First Time Homebuyer Credit Account Look-up tool for information on your repayments and account balance.
- Check the status of your amended return using Where’s My Amended Return? Go to IRS.gov, provide Where’s My Amended Return? in the search box. You can generally expect your amended return to be processed up to 12 weeks from the date we receive it. It can take up to 3 weeks from the date you mailed it to show up in our system.
- Make a payment using one of several safe and convenient electronic payment options available on IRS.gov. Select the Payment tab on the front page of IRS.gov for more information.
- Determine if you are eligible and apply for an online payment agreement. If you owe more tax than you can pay today.
- Figure your income tax withholding with the IRS Withholding Calculator on IRS.gov. Use it if you’ve had too much or too little withheld. Your personal situation has changed, you’re starting a new job or you just want to see if you’re having the right amount withheld.
- Determine if you might be subject to the Alternative Minimum Tax by using the Alternative Minimum Tax Assistant on IRS.gov.
- Request an Electronic Filing PIN by going to IRS.gov and entering Electronic Filing PIN in the search box.
- Download forms, instructions and publications, including accessible versions for people with disabilities.
- Locate the nearest Taxpayer Assistance Center (TAC) using the Office Locator tool on IRS.gov, or choose the Contact Us option on the IRS2Go app and search Local Offices. An employee can answer questions about your tax account or help you set up a payment plan. Before you visit, check the Office Locator on IRS.gov or Local Offices under Contact Us on IRS2Go to confirm the address, phone number, days and hours of operation, and the services provided. If you have a special need, such as a disability, you can request an appointment. Call the local number listed in the Office Locator, or look in the phone book under United States Government, Internal Revenue Service.
- Apply for an Employer Identification Number (EIN). Go to IRS.gov and enter Apply for an EIN in the search box.
- Read the Internal Revenue Code, regulations, or other official guidance.
- Read Internal Revenue Bulletins.
- Sign up to receive local and national tax news and more by email. Just click on “subscriptions” above the search box on IRS.gov and choose from a variety of options.

Phone. You can call the IRS, or you can carry it in your pocket with the IRS2Go app on your smart phone or tablet. Download the free IRS2Go app from the iTunes app store or from Google Play.

- Call to locate the nearest volunteer help site, 1-800-906-9887 or you can use the VITA Locator Tool on IRS.gov, or download the IRS2Go app. Low-to-moderate income, elderly, people with disabilities, and limited English proficient taxpayers can get free help with their tax return from the nationwide Volunteer Income Tax Assistance (VITA) program. The Tax Counseling for the Elderly (TCE) program helps taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing. Some VITA and TCE sites provide IRS-certified volunteers who can help prepare your tax return. Through the TCE program, AARP offers the Tax-Aide counseling program; call 1-888-227-7669 to find the nearest Tax-Aide location.
- Call the automated Where’s My Refund? information hotline to check the status of your 2013 refund 24 hours a day, 7 days a week at 1-800-829-1954. If you e-file, you can start checking on the status of your return within 24 hours after the IRS receives your tax return or 4 weeks after you’ve mailed a paper return. The IRS issues more than 9 out of 10 refunds in less than 21 days. Where’s My Refund? will give you a personalized refund date as soon as the IRS processes your tax return and approves your refund. Before you call this automated hotline, have your 2013 tax return handy so you can enter your social security number.
security number, your filing status, and the exact whole dollar amount of your refund. The IRS updates Where's My Refund? every 24 hours, usually overnight, so you only need to check once a day. Note, the above information is for our automated hotline. Our live phone and walk-in assistants can research the status of your refund only if it’s been 21 days or more since you filed electronically or more than 6 weeks since you mailed your paper return.

- Call the Amended Return Hotline. 1-866-464-2050, to check the status of your amended return. You can generally expect your amended return to be processed up to 12 weeks from the date we receive it. It can take up to 3 weeks from the date you mailed it to show up in our system.
- Call 1-800-TAX-FORM (1-800-829-3676) to order current-year forms, instructions, publications, and prior-year forms and instructions (limited to 5 years). You should receive your order within 10 business days.
- Call TeleTax, 1-800-829-4477, to listen to pre-recorded messages covering general and business tax information. If, between January and April 15, you still have questions about the Form 1040, 1040A, or 1040EZ (like filing requirements, dependents, credits, Schedule D, pensions and IRAs or self-employment taxes), call 1-800-829-1040.
- Call using TTY/TDD equipment, 1-800-829-4059 to ask tax questions or order forms and publications. The TTY/TDD telephone number is for people who are deaf, hard of hearing, or have a speech disability. These individuals can also contact the IRS through relay services such as the Federal Relay Service.

Walk-in. You can find a selection of forms, publications and services — in-person.

- Products. You can walk in to some post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, and city and county government offices have a collection of products available to photocopy from reproducible proofs.
- Services. You can walk in to your local TAC for face-to-face tax help. An employee can answer questions about your tax account or help you set up a payment plan. Before visiting, use the Office Locator tool on IRS.gov, or choose the Contact Us option on the IRS2Go app and search Local Offices for days and hours of operation, and services provided.

Mail. You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 business days after your request is received.

Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, Illinois 61705-6613

The Taxpayer Advocate Service is Here to Help You. The Taxpayer Advocate Service (TAS) is your voice at the IRS. Our job is to ensure that every taxpayer is treated fairly and that you know and understand your rights.

What can TAS do for you? We can offer you free help with IRS problems that you can't resolve on your own. We know this process can be confusing, but the worst thing you can do is nothing at all! TAS can help if you can't resolve your tax problem and:

- Your problem is causing financial difficulties for you, your family, or your business.
- You face (or your business is facing) an immediate threat of adverse action.
- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

If you qualify for our help, you'll be assigned to one advocate who'll be with you at every turn and will do everything possible to resolve your problem. Here's why we can help:

- TAS is an independent organization within the IRS.
- Our advocates know how to work with your IRS.
- Our services are free and tailored to meet your needs.
- We have offices in every state, the District of Columbia, and Puerto Rico.

How can you reach us? If you think TAS can help you, call your local advocate, whose number is in your local directory and at Taxpayer Advocate, or call us toll-free at 1-877-777-4778.

How else does TAS help taxpayers?

TAS also works to resolve large-scale, systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through our Systemic Advocacy Management System.

Low Income Taxpayer Clinics

Low Income Taxpayer Clinics (LITCs) serve individuals whose income is below a certain level and need to resolve tax problems such as audits, appeals and tax collection disputes. Some clinics can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. Visit Taxpayer Advocate or see IRS Publication 4134, Low Income Taxpayer Clinic List.

Controlled foreign corporation shareholder 6, 11
Covered asset acquisition 9
Credit:
How to claim 25
How to figure 11
Limit on 11
Credit for taxes paid or accrued 3

Deduction for foreign taxes that are not income taxes 2
Distributions:
Lump-sum 12
Dividends:
Taxes on 9
Dual-capacity taxpayers 7

Index

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