

# Instructions for Form 1116

## Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual)

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

### General Instructions

#### Election To Claim the Foreign Tax Credit Without Filing Form 1116

You may be able to claim the foreign tax credit without filing Form 1116. By making this election, the foreign tax credit limitation rules (lines 14 through 21 of the form) will not apply to you. This election is available **only** if you meet **all** of the following conditions:

- All your foreign source gross income was from the “passive income” category (which includes most interest and dividends) (see page 3). However, for this purpose, passive income also includes (a) income subject to the special rule for high-taxed income described on page 4; (b) income that would be passive except that it is also described in another category; and (c) certain export financing interest. See **Pub. 514**, Foreign Tax Credit for Individuals, for details.
- All the income and any foreign taxes paid on it were reported to you on a qualified payee statement. Qualified payee statements include Form 1099-DIV, Form 1099-INT, Schedule K-1 (Form 1041), Schedule K-1 (Form 1065), Schedule K-1 (Form 1065-B), Schedule

K-1 (Form 1120S), or similar substitute statements.

- Your total creditable foreign taxes are not more than \$300 (\$600 if married filing a joint return).

This election is not available to estates or trusts.

If you make this election:

- You may not carry over any excess foreign taxes paid or accrued to or from a tax year to which the election applies (but carryovers to and from other years are unaffected).
- You are still required to take into account the general rules for determining whether a tax is creditable. See **Foreign Taxes Eligible for a Credit** and **Foreign Taxes Not Eligible for a Credit** on page 2.
- You are still required to reduce the taxes available for credit by any amount you would have entered on line 12 of Form 1116. See the instructions for **Line 12** on page 10.

To make the election, just enter on the foreign tax credit line of your tax return (for example, Form 1040, line 43) the **smaller** of (a) your total foreign tax or (b) your regular tax (for example, Form 1040, line 40).

#### Purpose of Form

**Who should file.** File Form 1116 to claim the foreign tax credit if the election above does not apply and:

- You are an individual, estate, or trust **and**
- You paid or accrued certain foreign taxes to a foreign country or U.S. possession.

See **Foreign Taxes Eligible for a Credit** on page 2 to determine if the taxes you paid or accrued qualify for the credit.

**Do not** use Form 1116 to figure a credit for taxes paid to the Virgin Islands. Instead, use **Form 8689**, Allocation of Individual Income Tax to the Virgin Islands.

**Nonresident aliens.** If you are a nonresident alien, you generally cannot take the credit. However, you may be able to take the credit if:

- You were a 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.

See section 906 for more information on the foreign tax credit allowed to a nonresident alien individual.

#### Credit or Deduction

Instead of claiming a credit for eligible foreign taxes, you may choose to deduct foreign income taxes on **Schedule A (Form 1040)**, Itemized Deductions.

Generally, if you take the credit for any eligible foreign taxes, you may not take any part of that year’s foreign taxes as a deduction. However, even if you take the credit for eligible foreign taxes for the year, you may take a deduction for:

- Foreign taxes not allowed as a credit because of boycott provisions.
- Taxes paid to certain foreign countries for which a credit has been denied as described in item 2 under **Foreign Taxes Not Eligible for a Credit** on page 2.
- Taxes on dividends that are not creditable because you do not meet the stock-holding period requirement as described in item 3 under **Foreign Taxes Not Eligible for a Credit** on page 2.
- Certain taxes paid or accrued to a foreign country in connection with the purchase or sale of oil or gas extracted in

#### For More Information

For more information about, or assistance in figuring, the foreign tax credit, the following IRS resources are available:

##### IRS Contacts

- In the United States and Puerto Rico: Call 1-800-829-1040 or visit your local IRS office.
- Overseas: Call 215-516-2000 (not toll free) or contact IRS offices at U.S. embassies in Mexico City, Berlin, London, Paris, Rome, Singapore, or Tokyo, or write to: Internal Revenue Service, International Section, P.O. Box 920, Bensalem, PA 19020-8518.

##### Publications

- **Pub. 54**, Tax Guide for U.S. Citizens and Resident Aliens Abroad.
- **Pub. 514**, Foreign Tax Credit for Individuals.
- **Pub. 519**, U.S. Tax Guide for Aliens.
- **Pub. 570**, Tax Guide for Individuals With Income From U.S. Possessions.
- **Pub. 575**, Pension and Annuity Income.

that country as described in item 6 under **Foreign Taxes Not Eligible for a Credit** below.

If you want to change your election to take a deduction instead of a credit, or a credit instead of a deduction, you must do so within a special 10-year limitation period. See Pub. 514 for more information.

## Foreign Taxes Eligible for a Credit

You may take a credit for income, war profits, and excess profits taxes paid or accrued during the tax year to any foreign country or U.S. possession, or any political subdivision (for example, city, state, or province), agency, or instrumentality of the country or possession. This includes taxes paid or accrued **in lieu of** a foreign or possession income, war profits, or excess profits tax that is otherwise generally imposed. For purposes of the credit, U.S. possessions include Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa.

U.S. citizens living in certain treaty countries may be able to take an additional foreign tax credit for foreign tax imposed on certain items of income from the United States. See **Tax Treaties** in Pub. 514 for details. If this applies to you, use the worksheet in Pub. 514 to help you figure this additional credit.

## Foreign Taxes Not Eligible for a Credit

You may not take a credit for the following foreign taxes:

1. Taxes paid to a foreign country that you do not legally owe, including amounts eligible for refund by the foreign country. If you do not exercise your available remedies to reduce the amount of foreign tax to what you legally owe, a credit for the excess amount is not allowed.

**Example.** Country X withholds \$25 of tax from a payment made to you. Under the income tax treaty between the United States and Country X, you owe only \$15 and may claim a refund from Country X for the other \$10. Only \$15 is eligible for the foreign tax credit (whether or not you apply for a refund).

2. Taxes imposed by and paid to certain foreign countries. These countries are those designated by the Secretary of State as countries that repeatedly provide support for acts of international terrorism, countries with which the United States does not have diplomatic relations, or countries whose governments are not recognized by the United States. Pub. 514 contains a list of these countries.

3. Foreign taxes paid with respect to a dividend from a corporation, if you have not held the stock for at least 16 days within the 30-day period that begins 15 days before the ex-dividend date. This required holding period is greater for preferred-stock dividends attributable to

periods totaling more than 366 days. See section 901(k)(3).

4. Foreign taxes withheld on a dividend to the extent that you have to make related payments on positions in similar or related property.

**Example.** You receive a dividend subject to foreign withholding tax. You are obligated to pay someone else an amount equal to all these dividends you receive. You may not claim a foreign tax credit for the withholding tax on these dividends.

5. Payments of foreign tax that are returned to you in the form of a subsidy.

6. 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 the purchase or sale.

7. Foreign taxes paid or accrued on income for which you are claiming an exclusion on **Form 8873**, Extraterritorial Income Exclusion. However, see section 943(d) for an exception for certain withholding taxes.

You **may not** take a credit for any interest or penalties you must pay.

## Foreign Currency Conversion

Report all amounts in U.S. dollars except where specified otherwise in Part II. If you have to convert from foreign currency, attach a detailed explanation of how you figured the conversion rate.

If you take a credit for taxes paid, the conversion rate is the rate of exchange in effect on the day you paid the foreign taxes. If you receive a refund of foreign taxes paid, the conversion rate is the rate in effect when you paid the taxes, **not** when you receive the refund.

If you choose to account for foreign income taxes on an accrual basis, you must generally use the average exchange rate for the tax year to which the taxes relate. However, you may **not** do so if either of the following apply:

- The foreign taxes are actually paid more than 2 years after the close of the tax year to which they relate.
- The foreign taxes are actually paid in a tax year prior to the year to which they relate.

Accrued foreign taxes not eligible for conversion at the yearly average exchange rate must be converted using the exchange rate on the date of payment of the tax.

If you have a qualified business unit, see Pub. 514 for special rules for converting foreign income and taxes into U.S. dollars. You may have a qualified business unit if you own and operate a business or are self-employed in a foreign country.

For more information on conversion of foreign currency into U.S. dollars, see Pub. 54.

## Foreign Tax Credit Redeterminations

If you claim a credit for foreign taxes paid, and you receive a refund of all or part of those taxes in a later year, you must file an amended return reducing the taxes credited by the amount refunded.

If you claim the foreign tax credit based on foreign taxes accrued instead of foreign taxes paid, your credit must be redetermined in any of the following situations:

1. Your accrued taxes when paid differ from the amount you claimed as a credit,

2. You do not pay the accrued taxes within 2 years after the close of the tax year to which they relate, **or**

3. After you pay the accrued taxes, you receive a full or partial refund of them.

If any of these situations occurs after you file your return, you must file **Form 1040X**, Amended U.S. Individual Income Tax Return, or other amended return, to notify the IRS so that your U.S. tax for the year or years affected can be redetermined. Complete and attach to Form 1040X (or other amended return) a revised Form 1116 for the tax year(s) affected. See Temporary Regulations section 1.905-4T(b) for more information.

Foreign taxes paid more than 2 years after the close of the tax year to which they relate may be taken into account in figuring the foreign tax credit for the year to which they relate. However, the taxes must be converted into dollars at the exchange rate in effect at the time they are paid.

**Note:** *The above instructions apply to taxes relating to tax years beginning after 1997. For the rules relating to taxes for years beginning before 1998, see Pub. 514.*

**Exception.** If the change in your foreign tax liability for a tax year beginning before 1998 occurred **only** because of changes in the exchange rate, you do not need to file Form 1040X or other amended return if the difference between the dollar value of the accrued foreign tax and the dollar value of the foreign tax you actually paid was less than the smaller of:

- \$10,000 **or**
- 2% of the foreign tax initially accrued.

If you meet this exception, adjust your U.S. tax for the year you paid the foreign tax instead of filing Form 1040X or other amended return.

**Note:** *If you do not notify the IRS of a foreign tax refund or change in the dollar amount of foreign taxes paid or accrued, you may have to pay a penalty.*

See Pub. 514 for more information.

## Income From Sources Outside the United States

This income generally includes, but is not limited to, the following:

**Worksheet for Lump-Sum Distributions**  
Keep for Your Records

- |   |          |
|---|----------|
| 1. Enter the amount from Form 1116, line 8 . . . . .  | 1. _____ |
| 2. Enter the amount from Form 4972, line 12, that is from <b>foreign</b> sources. Also enter this amount on Form 1116, line 16 . . . . .  | 2. _____ |
| 3. Enter the total amount from Form 4972, line 12. Also enter this amount on Form 1116, line 17 . . . . .   | 3. _____ |
| 4. Divide line 2 by line 3. Enter the result as a decimal (rounded to at least 4 places) here and on Form 1116, line 18. If line 2 is equal to or more than line 3, enter "1" . . . . . | 4. _____ |
| 5. Enter the amount from Form 4972, line 29. Also include this amount on Form 1116, line 19 . . . . .   | 5. _____ |
| <b>Caution: Do not include this amount in the tax you enter on line 19 of any other Form 1116 you are filing.</b>   |          |
| 6. Multiply line 5 by line 4. Enter the result here and on Form 1116, line 20 . . . . .   | 6. _____ |
| 7. Enter the <b>smaller</b> of line 1 or line 6 here and on Form 1116, line 21. To the left of line 21, write "LSD" . . . . .   | 7. _____ |

- Compensation for services performed outside the United States,
- Interest income from a payer located outside the United States,
- Dividends from a corporation incorporated outside the United States, **and**
- Gain on the sale of nondepreciable personal property you sold while maintaining a tax home outside the United States, if you paid a tax of at least 10% of the gain to a foreign country.

Special rules apply in determining the source of income from the sale of inventory; sale of depreciable property used in a trade or business; sale of intangible property such as a patent, copyright, or trademark; ocean activities; and transportation services that begin or end in the United States or a U.S. possession. See Pub. 514 for more information.

**Categories of Income**

Use a separate Form 1116 to figure the credit for each category of foreign source income listed above Part I of Form 1116. The following instructions tell you what kind of income to include in each category. For more information, see Pub. 514, section 904, and Regulations sections 1.904-4 and 1.904-5.

**a. Passive Income**

Passive income generally includes dividends, interest, royalties, rents, annuities, gain from the sale of property that produces such income or of non-income-producing investment property, and gains from foreign currency or commodities transactions. Capital gains not related to the active conduct of a trade or business are also generally passive income.

Passive income does **not** include high withholding tax interest, export financing

interest, active business rents and royalties from unrelated persons, or high-taxed income (see **High-Taxed Income** on page 4).

Passive income also does not include gain from the sale of inventory or property held primarily for sale to customers in the ordinary course of your trade or business; gain from commodities hedging transactions; and active business gains or losses of producers, processors, merchants, or handlers of commodities. It may also not include dividends or interest from a controlled foreign corporation (CFC). A foreign corporation may be a CFC if you own 10% or more of its stock.

**b. High Withholding Tax Interest**

In general, high withholding tax interest is foreign interest that is subject to a foreign withholding or other gross-basis tax of 5% or more.

**c. Financial Services Income**

Financial services income generally includes income derived by a financial services entity predominantly engaged in the active conduct of a banking, financing, insurance, or similar business. Financial services income of a financial services entity also includes passive income and certain incidental income; however, no part of the passive income that is financial services income is treated as high-taxed income (see **High-Taxed Income** on page 4).

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(e)(2)(i)(Y), you must show the type and amount of each item on an attachment to Form 1116.

**d. Shipping Income**

Shipping income generally includes income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, or income derived from space and ocean activities. Treat income that is both shipping income and financial services income as financial services income.

**e. Dividends From a DISC or Former DISC**

This category includes dividends from a DISC or former DISC to the extent these dividends are treated as foreign sourced. See section 992(a).

**f. Certain Distributions From a FSC or Former FSC**

This category includes distributions from a FSC or former FSC out of earnings and profits attributable to "foreign trade income." Foreign trade income is the gross income of a FSC attributable to foreign trading gross receipts.

**g. Lump-Sum Distributions**

You may take a foreign tax credit for taxes you paid or accrued on a foreign source lump-sum distribution from a pension plan. Special formulas may be used to figure a separate tax on a qualified lump-sum distribution for the year in which the distribution is received. See Pub. 575 for more information.

If you are able to elect, and do elect, to figure your U.S. tax on a distribution using **Form 4972**, Tax on Lump-Sum Distributions, a separate foreign tax credit limitation applies. Use a separate Form 1116. On this separate Form 1116, check box **g** above Part I. Skip Part I. Complete Part II showing only foreign taxes that are attributable to the lump-sum distribution. Then, complete the **Worksheet for Lump-Sum Distributions** above to figure the amounts to enter in Part III.

Special rules apply in figuring the foreign tax credit for any part of a lump-sum distribution for which you made the 20% capital gain election in Part II of Form 4972. See section 904(b)(2).

**h. Section 901(j) Income**

No credit is allowed for foreign taxes imposed by and paid or accrued to certain sanctioned countries. However, income derived from **each** such country is subject to a separate foreign tax credit limitation. Therefore, you must use a separate Form 1116 for income derived from each such country.

These countries are those designated by the Secretary of State as countries that repeatedly provide support for acts of international terrorism, countries with which the United States does not have diplomatic relations, or countries whose governments are not recognized by the United States. Pub. 514 contains a list of these countries.

**Note:** For periods beginning on or after February 1, 2001, the President of the

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

If you paid taxes to a country that ceased to be a sanctioned country during the tax year, see Pub. 514 for details on how to figure the foreign tax credit for the period that begins after the end of the sanctions.

**Note:** Since no credit is allowed for taxes paid to sanctioned countries, you would generally complete Form 1116 for this category only through line 16.

### i. Certain Income Re-sourced by Treaty

If a sourcing rule in an applicable income tax treaty treats any of the specific types of income described below as foreign source, and you elect to apply the treaty, the income will be treated as foreign source.

- Certain gains (section 865(h)) or
- Certain income from a U.S.-owned foreign corporation (section 904(g)(10)). See Regulations section 1.904-5(m)(7) for an example.

**Important:** 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. Add the amounts from line 21 of each separate Form 1116 and enter the total on line 28 of your summary Form 1116 (that is, the Form 1116 for which you are completing Part IV).

**Note:** Other types of income that are re-sourced under the terms of an income tax treaty (for example, compensation for services performed in the United States by a U.S. citizen resident in a foreign country) are not subject to a separate foreign tax credit limitation. However, the specific treaty may provide for other restrictions on the amount of income that is re-sourced or the amount of credit that is allowed with respect to foreign tax paid on re-sourced income. See, for example, article 24, paragraph 1, of the treaty between France and the United States.

### j. General Limitation Income

General limitation income is income that does not fall into one of the above categories. Common examples include:

- Wages, salary, and overseas allowances of an individual as an employee.
- Income earned in the active conduct of a trade or business that does not fall into one of the above categories.
- Gains from the sale of inventory or depreciable property used in a trade or

business that do not fall into one of the above categories.

## Special Rules

### High-Taxed Income

In some cases, passive income and taxes must be treated as general limitation income and taxes. Generally, passive income and taxes must be placed in the general limitation income category if the foreign taxes you paid on the income (after allocation of expenses) exceed the highest U.S. tax that can be imposed on the income. However, no part of the passive income that is financial services income is treated as high-taxed income. See Regulations section 1.904-4(c) for more information.

### Look-Through Rules

Certain income received or accrued by you as a 10% or more U.S. shareholder in a controlled foreign corporation (CFC) is treated as income in one of the separate limitation categories listed under

**Categories of Income** starting on page 3. For example, Subpart F inclusions, dividends, interest, rents, and royalties from a CFC are treated as separate limitation income to the extent they are attributable to separate limitation income of the CFC. See Regulations section 1.904-5 for more information.

### Reporting Foreign Tax Information From Partnerships and S Corporations

If you received a 2001 Schedule K-1 from a partnership or S corporation that includes foreign tax information, use the rules below to report that information on Form 1116.

### General Information for Partners and S Corporation Shareholders

**Less than 10% limited partners and certain less than 10% S corporation shareholders.** If you are a limited partner or an S corporation shareholder who does not actively participate in the management of the S corporation and you own a less than 10% interest (by value) in the partnership or S corporation, you generally may assign exclusively to the passive income category your distributive share of foreign source income and deductions from that partnership or S corporation. See Regulations section 1.904-5(h)(2) for more details and exceptions.

**Note:** This rule takes precedence over the income category rules outlined in the instructions that follow for lines 17c and 17d (or lines 15c and 15d) of the Schedule K-1 and the apportionment of deductions rules outlined in the instructions on page 5 for lines 17e(2) and 17f (or lines 15e(2) and 15f) of the Schedule K-1.

### Reporting amounts on Form 1116.

Include amounts reported to you on Schedule K-1 with any other amounts reportable on Form 1116 using:

- A separate Form 1116 for each category of income.
- A separate column in Part I and a separate line in Part II for each country or possession.

### Explanation of Certain Line Items on Schedule K-1

**Note:** In each instance that follows, the first line reference is to the Schedule K-1 for Form 1065 and the second line reference is to the Schedule K-1 for Form 1120S. (The Schedule K-1 for Form 1065-B includes all foreign tax information in an attachment for box 9.)

### Line 17b or line 15b—Gross income from all sources.

Combine your distributive share of “gross income from all sources” with all of your other gross income and enter the total on line 3e. Gross income from all sources is a constant amount (that is, you will enter the same amount on line 3e of all Forms 1116 that you file).

### Line 17c or line 15c—Gross income sourced at partner or shareholder level.

This line includes income from the sale of eligible personal property (most personal property other than inventory, depreciable property, and certain intangible property) (see Pub. 514 for details).

 Although all income reported to you on this line of the Schedule K-1 has been apportioned to separate categories of income, you must nevertheless first determine (using the rules below) whether the income on this line is U.S. source income or foreign source income. Then, enter only foreign source income in Part I of the applicable Forms 1116 (that is, the Forms 1116 for each category of income provided to you by the partnership or S corporation).

Use the following rules to source the income reported to you on this line of the Schedule K-1. If you are a U.S. resident (as defined below), the income is U.S. source income. If you are a nonresident (as defined below), the income is foreign source income.

**U.S. resident.** A U.S. resident is a U.S. citizen or resident alien who does not have a tax home in a foreign country or a nonresident alien who has a tax home in the United States.

**Tax home.** Generally, 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 not be treated as nonresidents for a sale of eligible personal property **unless** a foreign tax of 10% or more was paid or accrued on the gain on the sale (or, in the case of a loss sale, a foreign tax of 10% or more would have been paid had the sale resulted in a gain).

**Note:** To help you with these rules, the partnership has specifically identified for you:

- Gains on the sale of eligible personal property for which a foreign tax of 10% or more was paid or accrued.
- Losses on the sale of eligible personal property for which a foreign tax of 10% or more would have been paid had the sale resulted in a gain.

Include foreign source income in Part I of the applicable Form 1116 (that is, the Form 1116 for each category of income provided to you for this line of the Schedule K-1). **Do not** include income that you determined (using the above rules) to be U.S. source income in Part I of Form 1116.

 If the partnership or S corporation has specifically identified any capital gains or losses on this line (Schedule K-1, line 17c or 15c) and you have determined that those gains or losses are foreign source, see **Foreign Capital Gains and Losses** on this page before entering an amount in Part I of Form 1116.

**Line 17d or line 15d—Foreign gross income sourced at partnership or S corporation level.** Income reported on this line has already been sourced for you by the partnership or S corporation. The partnership or S corporation has reported this income to you by country and by category of income. Include these amounts in Part I of the applicable Forms 1116 (that is, the Forms 1116 for each category of income provided to you).

 If the partnership or S corporation has specifically identified any foreign source unrecaptured section 1250 gain on this line (Schedule K-1, line 17d or 15d), see **Foreign Capital Gains and Losses** on this page before entering an amount in Part I of Form 1116.

**Note:** If you received information on your Schedule K-1 pertaining to gross income attributable to a foreign branch, please disregard this information. It is intended only for corporate partners preparing Form 1118.

**Line 17e(1) or line 15e(1)—Interest expense.** See the instructions for line 4b on page 9 to allocate and apportion the interest expense shown on this line of Schedule K-1. In applying those instructions, take into account your distributive share of the partnership's or S corporation's gross income (for purposes of the \$5,000 threshold) or your pro rata share of the partnership's or S corporation's assets. However, if you were a limited partner or an S corporation

shareholder who did not actively participate in the management of the S corporation, and your interest in the partnership or S corporation was less than 10%, see the paragraph below. Include interest expense that you allocate to foreign source income on line 4b of the applicable Form 1116. Do not enter in Part I of Form 1116 any interest expense that you allocate to U.S. source income.

**Less than 10% limited partners and certain less than 10% S corporation shareholders.** If you are a limited partner or an S corporation shareholder (who does not actively participate in the management of the S corporation) and you own (directly or indirectly) a less than 10% interest (by value) in the partnership or S corporation, you may generally allocate your distributive share of interest expense from that partnership or S corporation to foreign or U.S. source income based on your distributive share of the gross foreign or U.S. source income of that partnership or S corporation. The interest expense you allocate to foreign source income generally may be apportioned exclusively to the passive income category. However, see Temporary Regulations section 1.861-9T(e)(4) for exceptions.

**Line 17e(2) or line 15e(2)—Other Expenses.** This line includes expenses (other than interest expense) of the partnership or S corporation that must be allocated and apportioned at the partner or shareholder level (for example, research and experimental expenses).

Combine your distributive share of these expenses with all of your other like expenses, if any, and then allocate and apportion them using the applicable rules (for example, for research and experimental expenses, the rules under Regulations section 1.861-17(f)).

Include expenses that you allocate to foreign source income on line 2 of the applicable Form 1116. Expenses that you allocate to U.S. source income should not be entered on any line of Part I of Form 1116.

**Line 17f or line 15f—Deductions allocated and apportioned at partnership or S corporation level to foreign source income.** The partnership or S corporation has already allocated these expenses to foreign source income and has reported them to you by country and by category of income. Include these amounts on line 2 of the applicable Forms 1116 (that is, the Forms 1116 for each category of income provided to you).

**Note:** If you received information on your Schedule K-1 pertaining to definitely allocable deductions attributable to a foreign branch, please disregard this information. It is intended only for corporate partners preparing Form 1118.

**Line 17g or line 15g—Total foreign taxes.** The partnership or S corporation has already allocated and apportioned total foreign taxes for you and has reported them to you by country and by

category of income. Include these amounts in Part II of the applicable Forms 1116 (that is, the Forms 1116 for each category of income provided to you).

**Line 17h or line 15h—Reduction in taxes available for credit.** The partnership or S corporation has already apportioned the reduction in taxes information for you and has reported it to you by country and by category of income. Include these amounts on line 12 of the applicable Forms 1116 (that is, the Forms 1116 for each category of income provided to you).

## Foreign Capital Gains and Losses

**Foreign Schedule D.** You must complete a separate Schedule D (a "foreign Schedule D") using only foreign gains and losses if:

- Line 17 of the Schedule D (Form 1040) (or line 16 of the Schedule D (Form 1041)) you are filing with your tax return is a gain **and** you have capital gains from sources outside the United States **or**
- You have capital losses from sources outside the United States.

 If your capital gains fall into two or more separate categories (for example, the passive income category and the general limitation income category) or if your capital losses fall into two or more separate categories, see Pub. 514 for information on how to report the amounts.

Complete the separate foreign Schedule D (Form 1040) through line 36 (or the separate foreign Schedule D (Form 1041) through line 34). If you are required to complete the **Schedule D Tax Worksheet**, you should instead complete the separate foreign Schedule D (Form 1040) through line 19 (or the separate foreign Schedule D (Form 1041) through line 17) and complete the Schedule D Tax Worksheet through line 33.

**Note:** If you enter zero or a loss on line 17 of your foreign Schedule D (line 16 of Schedule D (Form 1041)), **do not** complete Part IV of your foreign Schedule D (Form 1040) (Part V of the foreign Schedule D (Form 1041)) or the Schedule D Tax Worksheet. Also, **do not** complete **Worksheet A** on page 6. Instead, see **Foreign Capital Loss** on page 6.

Use your foreign Schedule D **only** to complete **Worksheet A** on page 6 or **Worksheet B** on page 7, whichever applies. Do not file it with your tax return.

**Foreign Capital Gain Tax Worksheet.** You **must** complete a separate Capital Gain Tax Worksheet (a "foreign Capital Gain Tax Worksheet") using only foreign gains and losses if:

- You figured your tax using the **Capital Gain Tax Worksheet** in the instructions for Form 1040 **and**
- Some or all of your capital gain distributions are from sources outside the United States.

**Worksheet A (Foreign Capital Gains)**  
Keep for Your Records

**Caution:** Before starting this worksheet:

- You must complete the **Worksheet for Line 17** on page 11.
- If you figured your tax using the **Capital Gain Tax Worksheet** in the instructions for Form 1040, see the instructions for **Foreign Capital Gain Tax Worksheet** that begin on page 5.

1. Enter the amount from line 14 of the **Worksheet for Line 17** . . . . . **1.** \_\_\_\_\_
2. Enter the amount from line 17 of your **foreign** Schedule D. (Estates and trusts should use line 16 of the **foreign** Schedule D (Form 1041).) **Note:** If the amount on line 16 of your foreign Schedule D (line 13 of foreign Schedule D (Form 1041)) is zero or a loss, enter the amount from line 2 on line 14 and go to line 15. . . . . **2.** \_\_\_\_\_
3. Enter the amount from line 30 of your foreign Schedule D Tax Worksheet . . . . . **3.** \_\_\_\_\_
4. Multiply line 3 by .3606 . . . . . **4.** \_\_\_\_\_
5. Enter the amount from line 33 of your foreign Schedule D Tax Worksheet . . . . . **5.** \_\_\_\_\_
6. Multiply line 5 by .2839 . . . . . **6.** \_\_\_\_\_
7. Enter your foreign source 8% gains (see instructions below) . . . . . **7.** \_\_\_\_\_
8. Multiply line 7 by .7954 . . . . . **8.** \_\_\_\_\_
9. Enter your foreign source 10% gains (see instructions below) . . . . . **9.** \_\_\_\_\_
10. Multiply line 9 by .7442 . . . . . **10.** \_\_\_\_\_
11. Enter your foreign source 20% gains (see instructions below) . . . . . **11.** \_\_\_\_\_
12. Multiply line 11 by .4885 . . . . . **12.** \_\_\_\_\_
13. Add lines 4, 6, 8, 10, and 12 . . . . . **13.** \_\_\_\_\_
14. Subtract line 13 from line 2 . . . . . **14.** \_\_\_\_\_
15. Compare lines 1 and 14. Enter the **smaller** here and include this amount on line 1 of Form 1116 . . . . . **15.** \_\_\_\_\_

Complete your **foreign Capital Gain Tax Worksheet** as follows:

1. Complete line 1 as instructed.
2. On line 2, enter your capital gain distributions from foreign sources. (This is the amount from Form 1040, line 13, that is from foreign sources.)
3. Complete lines 3 through 7 and lines 9 through 11 as instructed.
4. **Do not** complete line 8 or lines 12 through 15.

Use your **foreign Capital Gain Tax Worksheet** to complete Worksheet A above as follows:

1. Complete line 1 of Worksheet A as instructed.
2. On line 2, enter the amount from line 2 of your **foreign Capital Gain Tax Worksheet**.
3. Skip lines 3 through 8.

4. On line 9, enter the amount from line 7 of your **foreign Capital Gain Tax Worksheet**.
5. Complete line 10 as instructed.
6. On line 11, enter the amount from line 11 of your **foreign Capital Gain Tax Worksheet**.
7. Complete the remainder of Worksheet A as instructed.

**Foreign Capital Gain**

If line 17 of your foreign Schedule D (line 16 of foreign Schedule D (Form 1041)) is a gain, that gain may have to be adjusted before being taken into account on line 1 of Form 1116. Use Worksheet A to figure this adjustment. If line 17 of the Schedule D you filed with your tax return (line 16 of the Schedule D (Form 1041) you filed with your tax return) is zero or a loss, do not complete Worksheet A and do not include any capital gains on line 1 of Form 1116.

Also use Worksheet A if you figured your tax using the Capital Gain Tax Worksheet in the instructions for Form 1040 and part or all of your capital gain distributions are from sources outside the United States.

**Worksheet A, line 7.** Enter the amount from line 30 of your foreign Schedule D (line 28 of foreign Schedule D (Form 1041)) or, if you are required to complete a Schedule D Tax Worksheet, line 18 of your foreign Schedule D Tax Worksheet.

**Worksheet A, line 9.** Enter the amount from line 32 of your foreign Schedule D (line 30 of foreign Schedule D (Form 1041)) or, if you are required to complete the Schedule D Tax Worksheet, line 20 of your foreign Schedule D Tax Worksheet.

**Worksheet A, line 11.** Enter the amount from line 36 of your foreign Schedule D (line 34 of foreign Schedule D (Form 1041)) or, if you are required to complete the Schedule D Tax Worksheet, line 24 of your foreign Schedule D Tax Worksheet.

**Foreign Capital Loss**

Foreign capital losses, to the extent taken into account in determining foreign source capital gain net income (that is, to the extent foreign capital losses do not exceed foreign capital gains), must be adjusted before being taken into account on line 5 of Form 1116. Generally, capital losses exceeding capital gains may not be taken into account in determining net income. However, up to \$3,000 of net capital loss may offset ordinary income. See section 1211(b).

When figuring net capital loss, include gains and losses that are not from the sale or exchange of capital assets but that are treated as capital gains and losses, such as net section 1231 gains. For more information on foreign capital losses, see Pub. 514.

**Net Capital Loss From Foreign Sources**

If, after completing Parts I, II, and III of your foreign Schedule D, you have a net capital loss from foreign sources on line 17 (line 16 of Schedule D (Form 1041)), you must adjust the amount of your foreign loss based on the worldwide gain it offsets. See section 904(b)(2)(B)(iii). You may use **Worksheet B** on page 7 to make this required adjustment.

**Specific Instructions**

**Part I—Taxable Income or Loss From Sources Outside the United States**

 *Part I must be completed by all filers unless specifically indicated otherwise in these instructions.*

**Worksheet B (Foreign Capital Losses)**  
*Keep for Your Records*

**Note:** Treat all numbers as positive amounts.

1. Enter the loss from line 17 of your **foreign** Schedule D (line 16 of foreign Schedule D (Form 1041)) to the extent taken into account in determining your capital gain net income. **Note:** If line 17 of your foreign Schedule D (line 16 of foreign Schedule D (Form 1041)) is zero or a gain, **do not continue** with this worksheet . . . . . 1. \_\_\_\_\_
  
2. Add your **gains** from column (g), lines 8, 9, 11, 12, and 13 of the **Schedule D you are filing with your tax return** (column (g), lines 6, 7, 8, 9, and 10 of Schedule D (Form 1041)). **Note:** To determine the amount to enter from line 12 (line 8 of Schedule D (Form 1041)), aggregate only 28% rate gains in column (g) from **all** your Schedules K-1 2. \_\_\_\_\_
3. Multiply line 2 by 28% (.28) . . . . . 3. \_\_\_\_\_
4. Adjusted gross unrecaptured section 1250 gain. Enter the amount from line 8 of the **Worksheet for Unrecaptured Section 1250 Gain** on page 8 . . . . . 4. \_\_\_\_\_
5. Multiply line 4 by 25% (.25) . . . . . 5. \_\_\_\_\_
6. Add only your **gains** from column (f), lines 8, 9, 11, 12, and 13 of the **Schedule D you are filing with your tax return** (column (f), lines 6, 7, 8, 9, and 10 of Schedule D (Form 1041)). **Note:** To determine the amount to enter from line 12 (line 8 of Schedule D (Form 1041)), aggregate only long-term capital gains in column (f) from **all** your Schedules K-1 . . . . . 6. \_\_\_\_\_
7. Add lines 2 and 4 . . . . . 7. \_\_\_\_\_
8. Subtract line 7 from line 6 . . . . . 8. \_\_\_\_\_
9. If line 36 of the **Schedule D you are filing with your tax return** (line 34 of Schedule D (Form 1041)) or line 24 of the Schedule D Tax Worksheet is more than zero, multiply line 8 above by 20% (.20) and enter the result on line 9. Skip lines 10 through 14 and go to line 15. Otherwise, skip line 9 and go to line 10 . . . . . 9. \_\_\_\_\_
10. Enter the amount from line 30 of the **Schedule D you are filing with your tax return** (line 28 of Schedule D (Form 1041)) or line 18 of the Schedule D Tax Worksheet . . . . 10. \_\_\_\_\_
11. Enter the smaller of line 8 or line 10 . . . . . 11. \_\_\_\_\_
12. Multiply line 11 by 8% (.08) . . . . . 12. \_\_\_\_\_
13. Subtract line 11 from line 8. If zero or less, enter -0- . . . . . 13. \_\_\_\_\_
14. Multiply line 13 by 10% (.10) . . . . . 14. \_\_\_\_\_
15. Add only your **gains** from column (f), lines 1, 2, 4, and 5 of the **Schedule D you are filing with your tax return** (column (f), lines 1, 2, and 3 of Schedule D (Form 1041)). **Note:** To determine the amount to enter from line 5 (line 3 of Schedule D (Form 1041)), aggregate only short-term capital gains in column (f) from **all** your Schedules K-1 . . . . 15. \_\_\_\_\_
16. Multiply line 15 by 39.1% (.391) . . . . . 16. \_\_\_\_\_
17. Add lines 3, 5, 9, 12, 14, and 16 . . . . . 17. \_\_\_\_\_
18. Add lines 2, 4, 8, and 15 . . . . . 18. \_\_\_\_\_
19. Divide line 17 by line 18. **Note:** Your result should be a number between .08 and .391 . . . . . 19. \_\_\_\_\_
20. Divide line 19 by .391 . . . . . 20. \_\_\_\_\_
21. Multiply line 1 by line 20. This is your adjusted net capital loss from foreign sources. Enter here and include on line 5 of Form 1116 . . . . . 21. \_\_\_\_\_

**Worksheet for Unrecaptured Section 1250 Gain**  
**(for use with Worksheet B)**  
*Keep for Your Records*

1. For each section 1250 property listed in Form 4797, Part III (but not on Form 6252): Subtract line 26g of Form 4797 from the **smaller of line 22 or 24 of Form 4797**. Enter the total of the amount(s) here . . . **1.** \_\_\_\_\_
2. Enter the total unrecaptured section 1250 gain included on line 26 or line 37 of Form(s) 6252 from installment sales of trade or business property held more than 1 year . . . . . **2.** \_\_\_\_\_
3. Total any amounts reported to you on Schedules K-1 from a partnership or an S corporation as "unrecaptured section 1250 gain" and enter here . . . . . **3.** \_\_\_\_\_
4. Add lines 1 through 3 . . . . . **4.** \_\_\_\_\_
5. Enter the **smaller** of line 4 **or** the gain, if any, from Form 4797, line 7 **5.** \_\_\_\_\_
6. Enter the total unrecaptured section 1250 gain from sales (including installment sales) or other dispositions of section 1250 property held more than 1 year (but not included on any of the above lines). Also include gain from the sale or exchange of an interest in a partnership attributable to section 1250 gain . . . . . **6.** \_\_\_\_\_
7. Total any amounts reported to you as "unrecaptured section 1250 gain" from an estate, trust, real estate investment trust, or mutual fund (or other regulated investment company) and enter here . . . . . **7.** \_\_\_\_\_
8. Add lines 5 through 7. Enter the result here and on line 4 of **Worksheet B** on page 7 . . . . . **8.** \_\_\_\_\_

deductions on Schedule A (Form 1040), line 28, because your adjusted gross income was more than \$132,950 (\$66,475 if married filing separately), you must reduce each of the itemized deductions that are subject to the reduction by the reduction percentage before you complete lines 2, 3a, and 4a.

Use the **Itemized Deductions Worksheet** in the Instructions for Schedule A (Form 1040) 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 percentage (expressed as a decimal rounded to at least three places) to each itemized deduction subject to the reduction to determine the amount to enter on the appropriate line of Form 1116.

**Note:** You do not need to make this computation if the entire amount of your itemized deductions is entered on any **one** of the following lines: line 2, line 3a, or line 4a. Just enter your reduced itemized deductions on that line.

**Example.** You are single and have an adjusted gross income of \$192,950. Your itemized deductions subject to the overall reduction (line 3 of the worksheet) total \$20,000. This amount includes a deduction for gifts to charity of \$12,000. The other \$8,000 (\$20,000 – \$12,000) of itemized deductions are definitely related to the income on Form 1116, line 1.

The amount of the overall reduction on line 9 of the worksheet is \$1,800. To figure the amount of the charitable deduction to include in the total for line 3a of Form 1116, divide the amount on line 9 (\$1,800) by the amount on line 3 (\$20,000). This is your reduction percentage (9%). You must reduce your \$12,000 deduction by \$1,080 (9% x \$12,000). The reduced deduction of \$10,920 (\$12,000 – \$1,080) is the amount to enter on line 3a of Form 1116. Make a similar computation to figure the amount of definitely related itemized deductions to enter on line 2.

**Line 2**

 **Before you complete line 2, read Itemized deduction limit on this page.**

Enter your deductions that definitely relate to the gross income from foreign sources shown on line 1. For example, if you are an employee reporting foreign earned income on line 1, include on line 2 expenses such as those incurred to move to a new principal place of work outside the United States or supplies you bought for your job outside the United States.

**Do not** include any interest expense on line 2. See lines 4a and 4b for special rules for interest expense.

**Line I—Foreign Country or U.S. Possession**

Generally, if you received income from, or paid taxes to, more than one foreign country or U.S. possession, report information on a country-by-country basis on Form 1116, Parts I and II. Use a separate column in Part I and a separate line in Part II for each country or possession. If you paid taxes to more than three countries or possessions, attach additional sheets following the format of Parts I and II.

**Line 1—Foreign Gross Income**

Include income in the category checked above Part I that is taxable by the United States and is from sources within the country entered on line I. You must include income even if it is not taxable by that foreign country. Identify the type of income on the dotted line next to line 1. **Do not** include any earned income excluded on **Form 2555**, Foreign Earned Income, or **Form 2555-EZ**, Foreign Earned Income Exclusion.

**Example.** If you received dividends (passive income) and wages (general limitation income) from foreign sources, you must complete two Forms 1116. On one Form 1116, check box **a** (passive income), enter the dividends on line 1, and write "Dividends" on the dotted line. On the other Form 1116, check box **j** (general limitation income), enter wages **not** excluded on Form 2555 or Form 2555-EZ on line 1, and write "Wages" on

the dotted line. Complete Parts I, II, and III of each Form 1116. Then, complete the summary Part IV on one Form 1116.

 **If you are filing a Form 1116 that includes capital gains or losses from foreign sources, see Foreign Capital Gains and Losses starting on page 5.**

**Lines 2 Through 5—Deductions and Losses**

You must reduce your foreign gross income on line 1 by entering on lines 2 through 5:

- Any of your deductions that definitely relate to that foreign income **and**
- A ratable share of your other deductions that do not definitely relate to either that foreign income or to your U.S. source income.

**Do not include:**

- Deductions and losses related to exempt or excluded income, such as foreign earned income you have excluded on Form 2555 or Form 2555-EZ.
- The deduction for personal exemptions. Special rules apply to the allocation of research and experimental expenditures. See section 864(f).

If the law of a U.S. state to which you pay income taxes does not specifically exempt foreign source income from tax, you may be required to make a special allocation of state taxes you paid. See Pub. 514 for more information.

**Itemized deduction limit.** If you must reduce the total amount of your itemized

**Worksheet for Home Mortgage Interest—Line 4a**  
*Keep for Your Records*

**Note:** Before you complete this worksheet, read the instructions for line 4a below.

1. Enter gross foreign source income\* of the type shown on Form 1116.  
**Do not** enter income excluded on Form 2555 or Form 2555-EZ . . . . 1. \_\_\_\_\_
2. Enter gross income from all sources. **Do not** enter income excluded on Form 2555 or Form 2555-EZ . . . . . 2. \_\_\_\_\_
3. Divide line 1 by line 2 and enter the result as a decimal (rounded to at least 3 places) . . . . . 3. \_\_\_\_\_
4. Enter deductible home mortgage interest (from lines 10 through 12 of Schedule A (Form 1040)\*\* . . . . . 4. \_\_\_\_\_
5. Multiply line 4 by line 3. Enter the result here and on Form 1116, line 4a . . . . . 5. \_\_\_\_\_

\*If you have to report income from more than one country on Form 1116, complete a separate worksheet for each country. Use only the income from that country on line 1 of the worksheet.

\*\*If you were required to reduce the amount of your itemized deductions on Schedule A, enter the reduced amount of home mortgage interest on line 4 of the worksheet.

**Lines 3a and 3b**

Some deductions do not definitely relate either to your foreign source income shown on line 1 or to your U.S. source income. Enter on lines 3a and 3b any deductions (other than interest expense) that:

- Are not shown on line 2 **and**
- Are not definitely related to your U.S. source income.

**Line 3a.** Before you complete line 3a, read **Itemized deduction limit** on page 8.

Enter the following itemized deductions (from Schedule A (Form 1040)) on line 3a:

- Medical expenses (line 4)
- Real estate taxes (line 6)
- Gifts to charity (line 18)

If you do not itemize deductions, enter your **standard deduction** on line 3a.

**Line 3b.** Enter on line 3b any other deductions that do not definitely relate to any specific type of income (for example, the deduction for alimony from Form 1040, line 31a).

**Lines 3d and 3e**

For lines 3d and 3e, gross income means income without regard to deductions and losses.

**Line 3d.** Enter your gross foreign source income from the category you checked above Part I of this Form 1116. If the category you checked is “general limitation income,” include any foreign earned income you have excluded on Form 2555 or Form 2555-EZ. However, if the category you checked is “passive income,” or “high withholding tax income,” **do not** include foreign earned income you have excluded.

If you had income from more than one country, you must enter income from only one country in each column.

**Line 3e.** Enter on line 3e in each column your gross income from **all** sources and **all** categories, both U.S. and foreign. This figure includes, but is not limited to, foreign earned income you have excluded on Form 2555 or Form 2555-EZ; tax-exempt interest from Form 1040, line 8b; and the nontaxable portion of U.S. social security benefits included on Form 1040, line 20a.

If you are a nonresident alien, include on both lines 3d and 3e your income that is not effectively connected with a trade or business in the United States.

**Line 3f**

Divide line 3d by line 3e and round off the result to at least 4 decimal places (for example, if your result is 0.8756782, round off to 0.8757, **not** to 0.876 or 0.88). Enter the result, but **do not** enter more than “1.”

**Line 4a**

If your gross foreign source income (including income excluded on Form 2555 or Form 2555-EZ) does not exceed \$5,000, you may allocate all of your interest expense to U.S. source income. Otherwise, deductible home mortgage interest (including points) is apportioned using a gross income method. Use the worksheet above to figure the amount to enter on line 4a. Before you complete the worksheet, read **Itemized deduction limit** on page 8.

**Line 4b**

Other interest expense includes investment interest, interest incurred in a trade or business, and passive activity interest. If you are a U.S. citizen, resident alien, or a domestic estate, and your gross foreign source income (including any income excluded on Form 2555 or Form 2555-EZ) does not exceed \$5,000, you may allocate all of your interest

expense to U.S. source income. Otherwise, each type of interest expense is apportioned separately using an “asset method.”

**Example.** You have investment interest expense of \$2,000. Your assets of \$100,000 consist of stock generating U.S. source income (adjusted basis, \$40,000) and stock generating foreign source income (adjusted basis, \$60,000). You apportion 40% (\$40,000/\$100,000) of \$2,000 or \$800 of your investment interest to U.S. source income and 60% (\$60,000/\$100,000) of \$2,000 or \$1,200 to foreign source income. In this example, you will enter the \$1,200 apportioned to foreign source income on line 4b. You would not enter the \$800 apportioned to U.S. source income on any line of Part I of Form 1116.

See Pub. 514 for more information.

**Line 5**

If you have losses from foreign sources that include net capital losses, see **Net Capital Loss From Foreign Sources** on page 6 for information on the adjustment you must make.

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**Part II—Foreign Taxes Paid or Accrued**

 See page 2 for descriptions of foreign taxes that **are** eligible for the foreign tax credit and foreign taxes that **are not** eligible for the foreign tax credit.

You may take a foreign tax credit in the tax year you paid or accrued the foreign taxes, depending on your method of accounting. If you report on the cash basis, you may choose to take the credit for accrued taxes by checking the “accrued” box in Part II. But once you choose to do this, you must credit foreign taxes in the year they accrue on all future returns.

Generally, you must enter in Part II the amount of foreign taxes, in both the foreign currency denomination(s) and as converted into U.S. dollars, that relate to the category of income checked above Part I. Taxes are related to the income if the income is included in the foreign tax base on which the tax is imposed. If the foreign tax you paid or accrued relates to more than one category of income, apportion the tax among the categories. The apportionment is based on the ratio of net foreign taxable income in each category to the total net income subject to the foreign tax. See Pub. 514 for an example.

However, if foreign tax paid on **passive income** is reported to you in U.S. dollars on a Form 1099-DIV, 1099-INT, or similar statement, you do not have to convert the amount shown into foreign currency. This rule applies whether or not you can make the election to claim the foreign tax credit without filing Form 1116 (as explained on page 1). Enter “1099 taxes” in Part II, column (o),

and complete columns (t) through (x) for each foreign country indicated in Part I.

**Note:** If you are taking a credit for additional taxes paid or accrued as the result of an audit by a foreign taxing authority or you are filing an amended return reflecting a foreign tax refund, attach a statement to Form 1116 identifying these taxes.

## Part III—Figuring the Credit

### Line 10

You may carry back 2 years and then forward 5 years any foreign tax you paid or accrued to any foreign country or U.S. possession (reduced as described below) on income in a separate category that is more than the limitation. First, apply the excess to the earliest year to which it may be carried. Then, apply it to the next earliest year, and so on. The 7-year carryback-carryforward period may not be extended even if you are unable to take a credit in one of the intervening years.

You cannot carry a credit to a tax year for which you claim a deduction, rather than a credit, for foreign taxes paid or accrued. Also, you must **reduce** the amount of any carryback or carryforward by the amount that you would have used had you chosen to claim a credit rather than a deduction in that year. Similarly, the 7-year period is not extended if you are unable to use a carryback or carryforward because you elected to claim the foreign tax credit without filing a Form 1116 (as explained on page 1).

File Form 1040X or other amended return and a revised Form 1116 for each earlier tax year to which you are carrying back excess foreign taxes.

Special rules apply to the carryback and carryforward of foreign taxes paid or accrued on foreign oil and gas extraction income. See section 907(f).

See Pub. 514 for more information on carryback and carryforward provisions, including examples.

### Line 12

You may have to reduce the foreign taxes you paid or accrued by the following items:

• **Taxes on income excluded on Form 2555 or Form 2555-EZ.** Reduce taxes paid or accrued by the taxes allocable to any foreign earned income excluded on Form 2555 or Form 2555-EZ. If only part of your foreign earned income is excluded, you must determine the amount of tax allocable to excluded income. To do so, multiply the foreign taxes paid or accrued on foreign earned income received or accrued during the tax year by the following fraction:

*Numerator:* Foreign earned income you **excluded** for the tax year reduced by otherwise deductible expenses allocable to that income.

*Denominator:* Your **total** foreign earned income received or accrued during the tax year reduced by deductible expenses allocable to that income. However, if the foreign jurisdiction charges tax on 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 is the total amount of income subject to foreign tax reduced by deductible expenses allocable to that income.

See Pub. 514 for a comprehensive example.

• **Taxes on income from Puerto Rico exempt from U.S. tax.** The reduction applies if you have income from Puerto Rican sources that is not taxable on your U.S. tax return. To figure the credit, reduce your foreign taxes paid or accrued by the taxes allocable to the exempt income. See Pub. 570 for more information.

• **Taxes on income from Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands excluded from U.S. tax.** If you are a bona fide resident of Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands, reduce taxes paid or accrued by any taxes attributable to excluded income from sources in Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands. For more information, see Pub. 570.

• **Taxes on foreign-oil related income.** Reduce taxes paid or accrued by foreign taxes paid or accrued on foreign-oil-related income, but only to the extent the tax imposed by the foreign country on the oil-related income is considered to be materially greater than the tax generally imposed by that country on other kinds of income. See Regulations section 1.907(b)-1. The amount of tax not allowed as a credit under this rule is allowed as a business expense deduction.

• **Taxes on foreign oil and gas extraction income.** Reduce taxes paid or accrued by taxes imposed on foreign oil and gas extraction income. The amount of the reduction is the amount by which your foreign oil and gas extraction taxes exceed the amount of your foreign oil and gas extraction income for the year multiplied by a fraction equal to your pre-credit U.S. tax liability (for example, Form 1040, line 40) divided by your worldwide income. You may be entitled to carry over to other years taxes reduced under this rule. See section 907(f).

• **Taxes on foreign mineral income.** Reduce taxes paid or accrued on mineral income from a foreign country or U.S. possession if you took a deduction for percentage depletion under section 613 for any part of the mineral income.

• **Reduction for failure to file Form 5471.** U.S. shareholders who control a foreign corporation must file **Form 5471**,

Information Return of U.S. Persons With Respect to Certain Foreign Corporations. If you do not file Form 5471 and furnish all of the information required by the due date of your tax return, reduce by 10% all foreign taxes that you otherwise may take into account for the foreign tax credit. You may have to make additional reductions if the failure continues. See section 6038(c) for details and exceptions.

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

• **Reduction for failure to file Form 8865.** U.S. partners who control a foreign partnership must file **Form 8865**, Return of U.S. Persons With Respect to Certain Foreign Partnerships. If you do not file Form 8865 and furnish all of the information required by the due date of your tax return, reduce by 10% all foreign taxes that you otherwise may take into account for the foreign tax credit. You may have to make additional reductions if the failure continues. See section 6038(c) for details and exceptions.

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

• **Reduction of taxes or credit due to international boycott operations.** In general, if you agree to participate in, or cooperate with, an international boycott, you must file **Form 5713**, International Boycott Report. Reduce either the total taxes available for credit or the credit otherwise allowable. If you can figure the taxes specifically attributable to boycott operations, enter the amount on line 12. If you cannot figure the amount of taxes specifically attributable to boycott operations, multiply the credit otherwise allowable by the international boycott factor and enter the result on line 32 of Part IV. Attach a statement showing in detail how you figured the reduction.

For more information, see Form 5713 and its instructions.

### Line 14

The amount on line 14 is your income from sources outside the United States before adjustments. If the amount on line 14 is zero or less, you generally have no foreign tax credit for the category of income checked above Part I of this Form 1116. However, you must complete line 15 and continue with the form even if line 14 is zero or less.

### Line 15

You are required to increase or decrease the amount on line 14 by the following adjustments. **The adjustments must be made in the order listed.** If you have more than one adjustment, enter the net adjustment on line 15 and attach a detailed statement showing your computation. See Pub. 514 for details. The adjustments are:

1. **Allocation of losses from other categories.** This adjustment applies only if you are completing more than one Form 1116. If you have a loss on line 14 of one

**Worksheet for Line 17 (Worldwide Capital Gains)**  
Keep for Your Records

**Caution:** If you figured your tax using the **Capital Gain Tax Worksheet** in the instructions for Form 1040, see the instructions for **Line 17** on page 12 before starting this worksheet.

1. Individuals: Enter the amount from Form 1040, line 37.  
Estates and trusts: Enter taxable income without the deduction for your exemption . . . . . **1.** \_\_\_\_\_
2. Enter the amount from line 17 of the Schedule D (Form 1040) (line 16 of Schedule D (Form 1041)) you are filing with your tax return. **Note:** If the amount on line 16 of this Schedule D (line 13 of Schedule D (Form 1041)) is zero or a loss, enter the amount from line 2 on line 14 and enter the amount from line 1 on line 15 . . . . . **2.** \_\_\_\_\_
3. Enter the amount from line 30 of the Schedule D Tax Worksheet **3.** \_\_\_\_\_
4. Multiply line 3 by .3606 . . . . . **4.** \_\_\_\_\_
5. Enter the amount from line 33 of the Schedule D Tax Worksheet **5.** \_\_\_\_\_
6. Multiply line 5 by .2839 . . . . . **6.** \_\_\_\_\_
7. Enter your worldwide 8% gains (see instructions on page 12) . . . **7.** \_\_\_\_\_
8. Multiply line 7 by .7954 . . . . . **8.** \_\_\_\_\_
9. Enter your worldwide 10% gains (see instructions on page 12) . . **9.** \_\_\_\_\_
10. Multiply line 9 by .7442 . . . . . **10.** \_\_\_\_\_
11. Enter your worldwide 20% gains (see instructions on page 12) . . **11.** \_\_\_\_\_
12. Multiply line 11 by .4885 . . . . . **12.** \_\_\_\_\_
13. Add lines 4, 6, 8, 10, and 12 . . . . . **13.** \_\_\_\_\_
14. Subtract line 13 from line 2. If you were required to complete **Worksheet A** on page 6, enter the result on line 1 of that worksheet . . . . . **14.** \_\_\_\_\_
15. Subtract line 13 from line 1. Enter the result here and on Form 1116, line 17 . . . . . **15.** \_\_\_\_\_

Form 1116 and you have income on line 14 of one or more other Forms 1116, you must **reduce** the foreign income by a pro rata share of the loss before you use any remaining loss to reduce U.S. source income.

**Example.** For 2001, you completed three Forms 1116. The first had a loss from general limitation income of \$2,000 on line 14, the second had income of \$4,000 from passive sources on line 14, and the third had income of \$1,000 from high withholding tax interest on line 14. You must allocate the \$2,000 loss between the passive income and the high withholding tax interest in the same proportion as each category's income bears to the total foreign income.

The amount of the loss that would reduce passive income would be 80% (\$4,000/\$5,000) of the \$2,000 loss or \$1,600. Enter the \$1,600 on line 15 of the passive income Form 1116. Assuming you have no other line 15 adjustments, enter \$2,400 (\$4,000 – \$1,600) on line 16 of that form.

The amount of the loss that would reduce high withholding tax interest would be 20% (\$1,000/\$5,000) of the \$2,000 loss or \$400. Enter the \$400 on line 15 of the high withholding tax interest Form 1116. Assuming you have no other line

15 adjustments, enter \$600 (\$1,000 – \$400) on line 16 of that form.

In this case, all of the \$2,000 loss was allocated between the foreign source passive income and the high withholding tax interest categories, and no reduction was made to U.S. source income. In situations where the loss to be allocated exceeds foreign income in other categories, the excess reduces U.S. source income and for later years you must follow the rules described under **Recapture of prior year overall foreign loss** below. If the loss reduced foreign source income, you must make certain adjustments to income you receive in the loss category in later years. See **Recharacterization of income** on page 12.

**2. Recapture of prior year overall foreign loss.** If you had an overall foreign loss in a prior year that offset U.S. source income, a part of your foreign income (in the same category as the loss) is treated as U.S. source income in each following tax year. The part that is treated as U.S. source income is the **smallest** of:

- a. The amount of overall foreign loss not recaptured in earlier years,
- b. 50% or more of your taxable income from foreign sources, or

c. The amount from line 14, less any adjustment for allocation of losses from other categories, as described under **Allocation of losses from other categories** beginning on page 10.

**Reduce** the income on line 14 by entering (in parentheses) on line 15 the smallest of **a**, **b**, or **c** above. This is the amount of the recapture. Be sure to attach your computation. If you elect to recapture more of an overall foreign loss than is required, show in your computation the percentage of taxable income recaptured and the dollar amount of the recapture.

**Dispositions of certain property.** If you recognized foreign source gain in the same category as the overall foreign loss on a disposition of property that was used predominantly in a foreign trade or business and that generated foreign source income in the same category as the overall foreign loss, then the gain on the disposition is subject to recapture as U. S. source income to the extent of 100% of your foreign source taxable income. See section 904(f)(3). Reduce line 14 by entering on line 15 the smaller of **(a)** the amount of the gain not recaptured under the preceding paragraph, **(b)** the remaining amount of the overall foreign loss not recaptured in

earlier years or in the current year under the preceding paragraph, and (c) the amount from line 14, less any adjustment for allocation of losses from other categories and any adjustment under the preceding paragraph. See Pub. 514 if you disposed of property described above and you recognized foreign source gain in a different category than the overall foreign loss, you recognized U.S. source gain, or you did not recognize gain.

Attach a statement to Form 1116 showing the balance in each separate limitation overall foreign loss account. See Regulations section 1.904(f)-1(b) for more information.

**3. Recharacterization of income.** If, in a prior tax year, you reduced your foreign taxable income in the category checked above Part I by a pro rata share of a loss from another category, you must recharacterize in 2001 all or part of any income you receive in 2001 in that loss category. **Increase** the amount on line 14 by entering on line 15 any recharacterized income.

Also include on line 15 income that must be recharacterized in 2001 as income in the category checked above Part I because of a foreign loss allocation that reduced U.S. source income in prior tax years.

**Example.** Using the facts in the example under **Allocation of losses from other categories** beginning on page 10, in the next year (2002), you have \$5,000 of general limitation income, \$3,000 of passive income, and \$500 of high withholding tax interest. Because \$1,600 of the general limitation loss was used to reduce your passive income in 2001, \$1,600 of your 2002 general limitation income must be recharacterized as passive income. Similarly, \$400 of the general limitation income must be recharacterized as high withholding tax interest. On your 2002 Form 1116 for passive income, you would enter \$1,600 on line 15. On your 2002 Form 1116 for high withholding tax interest, you would enter \$400 on line 15.

**Note:** *Recharacterizing income from a separate category does not result in recharacterizing any tax.*

**4. Allocation of U.S. losses.** If you have a net loss from U.S. sources in 2001, proportionately allocate that loss among the separate categories of your foreign income. **Reduce** the income on line 14 by entering (in parentheses) on line 15 the allocable portion of any U.S. loss. A U.S. loss includes a rental loss on property located in the United States.

### Line 17

If you are filing a Schedule D (Form 1040) with your tax return that shows a gain on line 23 or if you completed a Schedule D Tax Worksheet that shows a gain on line 4 (or if you figured your tax using the **Capital Gain Tax Worksheet** in the Instructions for Form 1040), you must use the worksheet on page 11 to figure the

amount to enter on line 17 of Form 1116. An estate or trust must complete the worksheet if Schedule D (Form 1041) shows a gain on line 21 or the Schedule D Tax Worksheet shows a gain on line 4.

**If you are filing Schedule D or used the Schedule D Tax Worksheet,** complete the worksheet on page 11 as follows:

1. Complete lines 1 through 6 as instructed.
2. On line 7, enter your worldwide 8% gains from line 30 of the Schedule D you are filing with your tax return (line 28 of Schedule D (Form 1041)). If you are required to complete the Schedule D Tax Worksheet, enter your worldwide 8% gains from line 18 of the Schedule D Tax Worksheet.
3. Complete line 8 as instructed.
4. On line 9, enter your worldwide 10% gains from line 32 of the Schedule D you are filing with your tax return (line 30 of Schedule D (Form 1041)). If you are required to complete the Schedule D Tax Worksheet, enter your worldwide 10% gains from line 20 of the Schedule D Tax Worksheet.
5. Complete line 10 as instructed.
6. On line 11, enter your worldwide 20% gains from line 36 of the Schedule D you are filing with your tax return (line 34 of Schedule D (Form 1041)). If you are required to complete the Schedule D Tax Worksheet, enter your worldwide 20% gains from line 24 of the Schedule D Tax Worksheet.
7. Complete the rest of the Worksheet for Line 17 as instructed.

**If you figured your tax using the Capital Gain Tax Worksheet in the Instructions for Form 1040,** complete the worksheet on page 11 as follows:

1. Complete line 1 as instructed.
2. On line 2, enter the amount from Form 1040, line 13 (that is, your taxable capital gain distributions).
3. Skip lines 3 through 8.
4. On line 9, enter the amount from line 7 of the **Capital Gain Tax Worksheet** in the Instructions for Form 1040.
5. Complete line 10 as instructed.
6. On line 11, enter the amount from line 11 of the **Capital Gain Tax Worksheet** in the Instructions for Form 1040.
7. Complete the rest of the Worksheet for Line 17 as instructed.

### Line 21

The maximum foreign tax credit you may claim in the current year is generally limited to the allocated amount of U.S. tax imposed on the foreign income, or the actual amount of foreign tax paid or accrued on the foreign income (after reductions required on line 12), whichever is **less**. However, see **Foreign Taxes Eligible for a Credit** on page 2 for additional information.

If the amount on line 20 is **smaller** than the amount on line 13, see Pub. 514

for more information on carryback and carryforward provisions, including examples.

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## Part IV—Summary of Credits From Separate Parts III

Complete lines 22 through 29 in Part IV only if you must complete more than one Form 1116 because you have more than one of the categories of income listed above Part I.

Complete Part IV on only **one** Form 1116 to summarize the credits you figured on all your Forms 1116. However, if you completed a Form 1116 for category **g** (lump-sum distributions) or **h** (section 901(j) income), **do not** use Part IV of that Form 1116 as your summary. Enter the credits from line 21 of all your Forms 1116 on lines 22 through 29 of the Form 1116 you are using to summarize your credits. File the other Forms 1116 as attachments.

### Line 31

Enter the smaller of line 19 or line 30.

**Note:** *Generally, line 30 will exceed line 19 only if you have U.S. capital gains that are subject to the capital gains rate differential (figured in the **Worksheet for Line 17** on page 11).*

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

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 2 hr., 43 min.; **Learning about the law or the form**, 1 hr.; **Preparing the form**, 2 hr., 50 min.; **Copying, assembling, and sending the form to the IRS**, 34 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the IRS at the address listed in the instructions of the tax return with which this form is filed.

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