1992

Department of the Treasury
Internal Revenue Service

Instructions for Form 1116

Foreign Tax Credit
Individual, Fiduciary, or Nonresident Alien Individual

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

General Instructions

A Change To Note

You may take a credit for taxes paid or accrued to South Africa on income attributable to or derived during the period beginning after July 10, 1991. If you did not take a credit for these taxes on your 1991 tax return, you may file Form 1040X (for individuals), or an amended return (for estates and trusts), to take the credit. Be sure to include a revised 1991 Form 1116 with Form 1040X or the amended return.

If you are figuring a credit for 1991 for taxes paid to South Africa and you paid taxes on more than one category of income, you must apportion those taxes to each separate category as described in **Part II—Foreign Taxes Paid or Accrued** on page 6. Then, figure the proportionate part of the taxes for each category that relates to the income attributable to or derived during the period after July 10, 1991. For details, see Pub. 514.

Note: *No credit is allowed for taxes paid or accrued to South Africa with respect to income attributable to or derived during the period January 1, 1988, through July 10, 1991.*

Who Should Use This Form

Use Form 1116 to figure your foreign tax credit if you are an individual, estate, or trust, and you paid or accrued foreign taxes for tax year 1992. See **Foreign Taxes For Which You May Take a Credit** on page 2 to determine if the taxes you paid or accrued qualify for the credit. If you are a nonresident alien see **Nonresident Aliens** below.

Use a separate Form 1116 (Parts I, II, and III) to figure the credit for foreign taxes paid or accrued for each category of income specified above Part I of the form. See **Categories of Income** on page 3 to find out what kind of income is contained in each category. If you have income from or have paid taxes to more than one foreign country or U.S. possession for one of the categories listed, 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.

Get **Pub. 514,** Foreign Tax Credit for Individuals, for more information about how to figure the foreign tax credit. You can get it from an IRS Forms Distribution Center.

If you claim a foreign tax credit, you may be liable for the alternative minimum tax. Get **Form 6251,** Alternative Minimum Tax, for more information.

Credit or Deduction

Instead of taking the credit on Form 1116, you may choose to deduct foreign income taxes on Schedule A (Form 1040). Generally, if you take the credit for any allowable foreign taxes, you may not take any part of that year's foreign tax as a deduction, either in the year you take the credit or in any later year. However, you may take a deduction for foreign taxes not allowed as a credit because of boycott provisions, even if you have taken the credit for other foreign taxes for the year. You may also deduct taxes paid to certain foreign countries for which a credit has been denied under section 901(j)(2), even if you take the credit for other foreign taxes.

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.

Nonresident Aliens

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

1. You are a resident of Puerto Rico during your entire tax year, or

2. You are a nonresident alien who pays or accrues 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. However, if you have to 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, that tax may not be used in figuring the amount of your credit.

Cat. No. 11441F

For more information, get **Pub. 519,** U.S. Tax Guide for Aliens.

Foreign Taxes for Which You May Take 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 (e.g., city, state, or province), agency, or instrumentality of the country or possession. These taxes include taxes that are paid or accrued in lieu of an income, war profits, or excess profits tax that is otherwise generally imposed. For purposes of figuring the credit, U.S. possessions include Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa.

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

U.S. citizens who live in France, Germany, Spain, Canada, Italy, Australia, New Zealand, Finland, India, or Tunisia may be able to take an additional foreign tax credit against their U.S. tax liability for the foreign tax imposed on certain items of income from the United States. There is a worksheet in Pub. 514 to help you figure this special credit. For more information about the credit, write to the Internal Revenue Service, Assistant Commissioner (International), Attention: IN:C:TPS, 950 L'Enfant Plaza South, S.W., Washington, DC 20024. You may also contact the United States Revenue Service Representative at the U.S. Embassies in Paris, Ottawa, Rome, Sydney, London, Singapore, or Sao Paulo, for assistance in figuring this credit.

Foreign Taxes for Which You May Not Take a Credit

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

1. Taxes attributable to excluded income from sources in American Samoa, Guam, or the Commonwealth of the Northern Mariana Islands if you are a bona fide resident of American Samoa. For more information, get **Pub. 570,** Tax Guide for Individuals With Income From U.S. Possessions.

2. Taxes imposed and paid on income earned from activities conducted in certain foreign countries. These countries include 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. Taxes paid to a foreign country that would be refunded to you if you made a refund claim.

4. Certain payments made to a foreign country for the purchase or sale of oil or gas if you do not have an economic interest in the oil or gas to which these payments apply. However, the purchase price paid or sales price received must be different from the fair market value of the oil or gas at the time of the purchase or sale.

5. Foreign taxes paid or accrued on foreign-oil-related income to the extent the tax imposed by the foreign country on the oil-related income is materially greater than the tax generally imposed by that country on other kinds of income. However, the amount of tax not allowed as a credit under this rule is allowed as a business expense deduction.

6. Payments of foreign tax that are returned to you in the form of a subsidy (such as a refund or credit).

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

Method of Reporting

Report all amounts on the form 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 take the credit for accrued taxes, the conversion rate is the rate of exchange in effect on the last day of your tax year. However, if a different rate of exchange is in effect when the tax is actually paid, see **Foreign Tax Redeterminations** below.

Note: *For information on how to convert foreign currency into U.S. dollars, get **Pub. 54,** Tax Guide for U.S. Citizens and Resident Aliens Abroad. See Pub. 514 for special rules for converting foreign income and taxes into U.S. dollars if you have a qualified business unit. You may have a qualified business unit if you own and operate a business or are otherwise self-employed in a foreign country.*

For more information on how to report foreign taxes, see **Part II—Foreign Taxes Paid or Accrued** on page 6.

Foreign Tax Redeterminations

A foreign tax redetermination is any change in your foreign tax liability that affects your U.S. foreign tax credit. A redetermination occurs if:

1. You must pay additional foreign taxes or you receive a foreign tax refund, or

2. There is a change in the dollar amount of your foreign tax credit because of differences in the exchange rate at the time the foreign taxes were accrued and the time they were paid.

If, after you file your return, your foreign tax is redetermined, you must file Form 1040X or an amended return to notify the IRS so that your U.S. tax for the year or years affected can be redetermined. You must complete and attach to Form 1040X or the amended return a revised Form 1116 for the tax year affected by the redetermination. The revised Form 1116 must reflect the changes made by the foreign tax redetermination. For more information, see Regulations section 1.905-4T(b).

Exception. If the change in your foreign tax liability occurred solely because of changes in the exchange rate (as in **2** above), you do not need to file Form 1040X or an 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 you may adjust your U.S. tax for the year of the foreign tax redetermination instead of filing Form 1040X or an 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 includes 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. This gain is from sources 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 income listed above Part I of Form 1116. The following instructions tell you what kind of income to include in each category.

Passive Income

Passive income generally includes dividends, interest, royalties, rents, and annuities. It also includes gain from the sale of non-income-producing investment property and gains from commodities transactions (except hedging transactions and active business gains or losses of producers, processors, merchants, or handlers of commodities). Passive income 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. Passive income also does not include foreign oil and gas extraction income, export-financing interest, active business rents and royalties from unrelated persons, or high-taxed income (see **High-Taxed Income** on page 5).

High Withholding Tax Interest

In general, high withholding tax interest is foreign interest that is subject to a foreign withholding or gross-basis tax of 5% or more. See Pub. 514.

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 includes passive income and certain incidental income. If you qualified as a financial services entity because you treated 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.

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. It also includes income derived from space and ocean activities. Income that is both shipping income and financial services income is treated as financial services income.

Dividends From a DISC or Former DISC

This category includes dividends from a DISC or former DISC (see section 992(a) for definitions) to the extent these dividends are treated as foreign source.

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" (as defined in section 923(b)).

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. But, if you figured your U.S. tax on the distribution using Part III or Part IV of **Form 4972,** Tax on Lump-Sum Distributions, a separate foreign tax credit limitation applies. Use a separate Form 1116 and the worksheet below to figure your credit.

Before you begin the worksheet, check the box above Part I of your separate Form 1116 for lump-sum distributions. Skip Part I. Then, complete Part II of Form 1116, showing only foreign taxes that are attributable to the lump-sum distribution. Use the worksheet below to figure the amounts to enter in Part III. Complete Part IV if it applies to you.

Worksheet for Lump-Sum Distributions
(keep for your records)

1. Enter the amount from Form 1116, line 8	
2. Enter the amount from Form 4972, line 14, or line 37, whichever applies, that is from **foreign** sources here and on Form 1116, line 16	
3. Enter the amount from Form 4972, line 14, or line 37, whichever applies, here and on Form 1116, line 17	
4. Divide line 2 by line 3. Enter the result as a decimal here and on Form 1116, line 18. If line 2 is equal to or more than line 3, enter the figure "1"	
5. Enter the amount from Form 4972, line 31, or line 54, whichever applies, here and on Form 1116, line 19 . . . . **Caution:** ***Do not*** *include this amount in the tax you enter on line 19 of any other Form 1116 you are filing.*	
6. Multiply line 5 by line 4. Enter the result here and on Form 1116, line 20	
7. Enter the smaller of line 1 or line 6 above here and on Form 1116, line 21. On the dotted line to the left of line 21 write "LSD." . .	

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).

General Limitation Income

Any income from sources outside the United States that does not fall into one of the categories above is general limitation income. Common examples of general limitation income are wages, salary, and overseas allowances of an individual as an employee. Other examples include income earned in the active conduct of a trade or business that does not fall into one of the other separate categories, and gains from the sale of inventory or depreciable property used in a trade or business that do not fall into one of the other separate categories.

For more information on the separate categories of income, see section 904 and Regulations sections 1.904-4 and 1.904-5.

Special Rules

Look-Through Rules

Certain income received or accrued by you as a U.S. shareholder in a controlled foreign corporation (CFC) is treated as income in a separate limitation category. Generally, Subpart F inclusions, dividends, interest, rents, and royalties from a CFC are treated as separate limitation income to the extent attributable to separate limitation income of the CFC. For more information, see Regulations section 1.904-5.

Income From a Partnership

Certain income from partnerships will be characterized under the look-through rules. But if a partner has a less than 10% interest (by value) in a partnership, income from the partnership is generally treated as passive income. See Regulations section 1.904-5(h) for more information.

Foreign Capital Gain

Capital gains not related to the active conduct of a trade or business are generally passive income. (See section 904 for more information.) Include on Form 1116 any gain from the sale or exchange of capital assets (including gains treated as capital gains under section 1231) only to the extent of foreign source capital gain net income. (This is either capital gain net income from sources outside the United States or from all sources, whichever is less.) "Capital gain net income" is the excess of gains over losses from the sale or exchange of capital assets.

Filers Using Maximum Capital Gains Tax Rate

If you figured your tax using Schedule D (Form 1040), Part IV, and any part of your capital gain was from foreign sources, complete the worksheet below to figure the amount of capital gain to include on line 1 of Form 1116. An estate or trust with foreign source capital gains should also use this worksheet if it figured its tax using the maximum 28% tax rate on capital gains.

Before you begin the worksheet, complete a separate Schedule D, using only gains and losses from sources outside the United States. On this Schedule D, complete lines 1 through 19 (lines 1 through 17 on Schedule D (Form 1041)). Also complete line 22 (line 37 on Schedule D (Form 1041)). In the worksheet below, this separate Schedule D is called "your foreign Schedule D." (Your foreign Schedule D is used only for purposes of figuring the gain or loss to include on Form 1116. DO NOT file it with your tax return.)

Caution: *If your capital gains or losses fall into two or more separate categories (e.g., the passive category and the general limitation category), do not use the worksheet below. Instead, see Pub. 514 for information on how to report the amounts.*

Worksheet for Capital Gains
(keep for your records)

1. Compare line 19 of your foreign Schedule D with line 19 of the Schedule D you are filing with your tax return. (Estates and trusts should use line 17 from Schedule D (Form 1041).) Enter the smaller of the two amounts. This is your foreign source capital gain net income. (If a loss appears on line 19 (line 17 on Schedule D (Form 1041)) of your foreign Schedule D, do not complete the rest of the worksheet. Instead see **Foreign Capital Loss** below.) **Note:** *If the amount on line 18 (line 16 on Schedule D (Form 1041)) of your foreign Schedule D is -0- or a loss, do not complete the rest of the worksheet. The amount on line 1 of the worksheet is the amount to include as capital gain on line 1, Form 1116* . . . ______

2. Compare line 22 of your foreign Schedule D with line 22 of the Schedule D you are filing with your tax return. (Estates and trusts should use line 37 from Schedule D (Form 1041).) Enter the smaller of the two amounts. This is your foreign source net capital gain . . . . . . ______

3. Multiply line 2 by .0968 . . . ______

4. Subtract line 3 from line 1. This is the amount to include as capital gain on line 1, Form 1116 . . ______

Foreign Capital Loss

Your gross income from foreign sources on Form 1116, line 1, is reduced by any net capital loss from foreign sources to the extent taken into account in figuring capital gain net income. 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.

Filers Using Maximum Capital Gains Tax Rate

If you figured your tax using Schedule D (Form 1040), Part IV, and you had a net capital loss from foreign sources, you must adjust the amount of this loss by completing the worksheet below. An estate or trust with a net capital loss from foreign sources should also use the worksheet below if it figured its tax using the maximum 28% tax rate on capital gains. For purposes of the worksheet, treat all numbers as positive amounts.

Caution: *If your capital gains or losses fall into two or more separate categories (e.g., the passive category and the general limitation category), do not use the worksheet below. Instead, see Pub. 514 for information on how to report the amounts.*

Worksheet for Capital Losses
(keep for your records)

1. Enter your net capital loss from foreign sources (to the extent taken into account in determining capital gain net income) . . . ______

2. Enter net capital gain from sources within the United States. (This is the excess of net long-term capital gains from U.S. sources over net short-term capital losses from U.S. sources.) ______

3. Enter the amount from line 22 of the Schedule D (Form 1040) you are filing with your tax return (line 37 of Schedule D (Form 1041)) ______

4. Subtract line 3 from line 2 . . ______

5. Multiply line 4 by .0968 . . . ______

6. Subtract line 5 from line 1. This is your net capital loss from foreign sources. Enter this amount here and on line 5 of Form 1116 . . ______

High-Taxed Income

In some cases, passive income may be placed in the general limitation income category. Passive income may qualify as general limitation income 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.

Specific Instructions

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

Line 1

Include any income in the category checked above Part I that is from sources within the country entered on line J that is taxable by the United States. You must include this income even if it is not taxable by that 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. Use a separate Form 1116 for each category of income you are reporting.

Example. If you received dividends (passive income) and wages (general limitation income) from a foreign source, you must complete two Forms 1116. On one Form 1116, enter the dividends on line 1, write “Dividends” on the dotted line, and complete the rest of the form. On the other Form 1116, enter wages (not excluded on Form 2555) on line 1 and write “Wages” on the dotted line. Complete the rest of Form 1116.

Allocating Deductions

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

- Any deductions you are taking that directly relate to that foreign income AND
- A ratable share of your other deductions that do not directly relate to either your foreign income on line 1 or your U.S. source income.

Do not include deductions and losses related to exempt or excluded income such as foreign earned income excluded on Form 2555. Do not include the deduction for personal exemptions.

Special rules apply to the allocation of research and experimental expenditures. See Rev. Proc. 92-56, 1992-28, I.R.B. 7.

If the law of a 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.

Itemized deduction limit.—If you are required to reduce the total amount of your itemized deductions on Schedule A (Form 1040), line 26, because your adjusted gross income was more than $105,250 ($52,625 if married filing separately), you must reduce each of the itemized deductions on Schedule A that are subject to the reduction by the reduction percentage before you complete lines 2, 3a, and 4 on Form 1116.

Use the **Itemized Deductions Worksheet** in the Instructions for 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 the reduction percentage to each itemized deduction to determine the amount to enter on the appropriate line of Form 1116.

Example. You are single and have an adjusted gross income of $155,250. 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 directly allocable to the income on Form 1116, line 1.

The amount of the overall reduction on line 9 of the worksheet is $1,500. 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 ($1,500) by the amount on line 3 ($20,000). This is your reduction percentage (7.5%). You must reduce your $12,000 deduction by $900 (7.5% × $12,000). The reduced deduction, $11,100 ($12,000 – $900) is the amount to include in the total for line 3a. Make a similar computation to figure the amount of directly allocable itemized deductions to enter on line 2 of Form 1116.

Note: *Even if you were required to reduce your itemized deductions on Schedule A, you do not need to make the computation described under **Itemized deduction limit** above if all of your itemized deductions are entered on either line 2, line 3a, or line 4a.*

Line 2

Enter all deductions that relate directly to the gross income from foreign sources shown on line 1. For example, if you are an employee reporting foreign earned income on Form 1116, line 2 may include 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.

Caution: *Before you complete line 2, read **Itemized deduction limit,** above.*

Lines 3a and 3b

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

- Are not shown on line 2; AND
- Are not directly related to your U.S. income.

Note: *If you do not itemize deductions, enter your standard deduction on line 3a and enter on line 3b any other deductions that do not relate to any specific type of income.*

Examples of itemized deductions from Schedule A (Form 1040) to enter on line 3a are: real estate taxes on a personal residence from line 6; medical expenses from line 4; and gifts to charity from line 16. Before you complete line 3a, read **Itemized deduction limit** above.

Enter on line 3b any deduction from gross income (Form 1040, lines 24a–30) that is not shown on line 2 and is not directly related to your U.S. income. An example of such a deduction is the deduction for alimony from Form 1040, line 29.

Lines 3d and 3e

Enter on line 3d your total foreign income from the category you checked at the top of Form 1116.

Enter on line 3e your gross income from ALL sources, both U.S. and foreign. For this computation, both foreign source income for line 3d and gross income from all sources for line 3e includes:

- If you are a nonresident alien, your income that is not effectively connected with a trade or business in the United States; or
- Foreign earned income excluded on Form 2555.

Line 4a

Deductible home mortgage interest (including points) is apportioned using a gross income method. Use the following worksheet to figure the amount to enter on line 4a of Form 1116. Before you complete the worksheet, read **Itemized deduction limit** on page 5.

Note: *If your foreign income (including income excluded on Form 2555) does not exceed $5,000, you may allocate all of your interest expense to U.S. source income.*

Worksheet for Home Mortgage Interest
(keep for your records)

1. Enter total foreign source income* of the type shown on Form 1116. **Do not** enter income excluded on Form 2555 . . . . ______

2. Enter gross income from all sources. **Do not** enter income excluded on Form 2555 . . . ______

3. Divide line 1 by line 2 and enter the result as a decimal . . . ______

4. Enter deductible home mortgage interest (from Schedule A (Form 1040))** . . . . ______

5. Multiply line 4 by the decimal on line 3. Enter the result here and on Form 1116, line 4a . . . ______

*If you are reporting 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.

Line 4b

Other interest expense includes investment interest, interest incurred in a trade or business, and passive activity interest. Each of these types of interest 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). Forty percent ($40,000/$100,000) of $2,000 or $800 of your investment interest is apportioned to U.S. source income and 60% ($60,000/$100,000) of $2,000 or $1200 is apportioned to foreign source income. In this example, the amount to enter on line 4b is the $1200 apportioned to foreign source income.

For more information, see Pub. 514.

Part II—Foreign Taxes Paid or Accrued

You may take the credit in the tax year you paid or accrued the 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. Once you choose to do this, however, you must credit foreign taxes in the year they accrue on all future returns.

Enter in Part II the amount of foreign taxes that relate to the category of income checked above Part I. Taxes are related to the income if the income is included in the base on which the tax is imposed. If the foreign tax you paid or accrued relates to more than one category of income, you must apportion the tax among the categories. The apportionment is based on the ratio of net foreign taxable income in each category to the net income subject to the foreign tax. See Pub. 514 for an example.

Note: *If you are taking a credit for additional taxes paid or accrued as the result of an audit by a foreign taxing authority, 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 the taxes you paid or accrued to any foreign country or U.S. possession (reduced as described below) on income in a separate category that are more than the limitation. First, apply the excess to the earliest of the 7 years to which it may be carried. Then apply it to the next earliest year, and so on. The 7-year carryback and carryover period may not be extended even if you are unable to take a credit in one of the intervening years.

If you did not take a credit in a tax year to which the excess is carried, the excess is considered used in that year as if you had claimed a credit.

Special rules apply to the carryback and carryover of foreign taxes paid or accrued on foreign-oil-related income. See section 907(f).

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

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.—Reduce taxes paid or accrued by the taxes allocable to foreign earned income excluded on Form 2555. If only part of your income is excluded, you must reduce the taxes paid or accrued by the amount allocable to the excluded income. To find the amount allocable to the excluded income, multiply the foreign taxes paid or accrued on foreign earned income received or accrued during the tax year by a fraction.

The numerator of the fraction is the foreign earned income excluded for the tax year less otherwise deductible expenses allocable to that income. The denominator is foreign earned income received or accrued during the tax year less deductible expenses allocable to that income. See the comprehensive example in Pub. 514. However, if the foreign law charges tax on foreign earned income and some other income (e.g., 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 less deductible expenses allocable to that income.

Taxes on income from Puerto Rico exempt from U.S. tax.—The reduction applies if you have income from Puerto Rican sources, such as U.S. Government wages, that is taxable on your U.S. income tax return, and you also 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 an example.

Taxes on foreign oil and gas extraction income.—Reduce taxes paid or accrued on foreign oil and gas extraction income as provided by section 907(a). See section 907(c)(4) for the rules regarding the recharacterization of foreign oil and gas extraction losses.

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 by the due date of your income tax return you do not file Form 5471, you must 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.

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, 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 for 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. Enter the result on line 31.

For more information, see Form 5713 and its instructions. If any of the above applies to you, attach a statement showing in detail how you figured the reduction.

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, skip lines 15 through 21. You have no foreign tax credit for the category of income checked at the top of this Form 1116. If you are required to recharacterize income from another category (see **Recharacterization of income** below), you must complete line 15 even if line 14 is zero or less.

Line 15

You are required to increase or decrease the amount on line 14 by the adjustments listed below. The adjustments must be made in the order listed. If you have more than one adjustment, enter the net adjustment on line 15. You must attach a schedule 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 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 the loss to reduce U.S. source income.

Example. In 1992, you completed three Forms 1116. The first one had a loss from general limitation income of $2,000 on line 14, the second one had income of $4,000 from passive income on line 14, and the third one had income of $1,000 from high withholding tax interest on line 14. The $2,000 loss must be allocated 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. The $1,600 would be entered on line 15 of the passive income Form 1116 and line 16 of that form would show $2,400 ($4,000–$1,600).

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. The $400 would be entered on line 15 of the high withholding tax interest Form 1116 and line 16 of that form would show $600 ($1,000–$400).

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 U.S. source income is reduced (the loss to be allocated exceeds foreign income in other categories), you must follow the rules described below under **Recapture of prior year overall foreign loss.**

Note: *If, for any tax year, you are required to allocate a foreign loss, you will need to make certain adjustments to income you receive in the loss category in later years. See* ***Recharacterization of income*** *below.*

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 from all categories, or **(c)** the amount from line 14, less any adjustment for allocation of losses from other categories, described above.

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, you must show in your computation the percentage of taxable income recaptured and the dollar amount of the recapture.

Regulations section 1.904(f)-1(b) requires that you attach a statement to Form 1116 showing the balance in each separate limitation overall foreign loss account.

3. Recharacterization of income.—If, in 1991, you reduced your foreign taxable income in the category shown at the top of Form 1116 by a pro rata share of a loss from another category, you must recharacterize in 1992 all or part of any income you receive in 1992 in that loss category. Increase the amount on line 14 by entering on line 15 any recharacterized income.

Also include on line 15 any income required to be recharacterized in 1992 as income in the category shown at the top of Form 1116 because of a foreign loss allocation in 1987, 1988, 1989, or 1990.

Example. Using the same facts in the example under **1** above, in the subsequent year (1993), you have $5,000 of general limitation income, $3,000 of passive income, and $500 of high withholding tax interest. Since $1,600 of the general limitation loss was used to reduce your passive income in 1992, $1,600 of your 1993 general limitation income must be recharacterized as passive income. This makes the total of passive income for 1993 $4,600. Similarly, $400 of the general limitation income must be recharacterized as high withholding tax interest, making the 1993 total of high withholding tax interest $900. The total income in the general limitation category is then $3,000. On your 1993 Form 1116 for passive income, you would enter $1,600 on line 15. On your 1993 Form 1116 for high withholding tax interest, you would enter $400 on line 15. If this is your only adjustment on line 15, the amount on line 16 of your Form 1116 for passive income would be $4,600, and the amount on line 16 of your Form 1116 for high withholding tax interest would be $900.

Note: *Recharacterization of 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 1992, you must 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 figured your tax using Schedule D (Form 1040), Part IV, use the worksheet below to figure the amount to enter on line 17. An estate or trust that used the maximum 28% tax rate on capital gains should also complete the worksheet.

Worksheet for Line 17

1. Enter the amount from line 22 of the Schedule D you are filing with your tax return (line 37 of Schedule D (Form 1041)) . .	______
2. Individuals: Enter the amount from Form 1040, line 35. Estates and trusts: Enter taxable income without the deduction for your exemption	______
3. Multiply line 1 by .0968 . . .	______
4. Subtract line 3 from line 2. Enter the result here and on Form 1116, line 17	______

Part IV—Summary of Credits From Separate Parts III

Complete this part on only one Form 1116 to summarize the credits you figured on separate Forms 1116. Enter the credits from line 21 of the separate Forms 1116 on lines 22 through 29, as appropriate. File the other Forms 1116 as attachments.