

the taxpayer's total foreign source taxable income. If the aggregate amount of maximum potential recapture in all overall foreign loss accounts exceeds fifty percent of the taxpayer's total foreign source taxable income, foreign source taxable income in each separate category with an overall foreign loss account is recharacterized in an amount equal to the section 904(f)(1) recapture amount, multiplied by the maximum potential recapture in the overall foreign loss account, divided by the aggregate amount of maximum potential recapture in all overall foreign loss accounts. The maximum potential recapture in any account is the lesser of the balance in that overall foreign loss account (after reduction of such accounts in accordance with § 1.904(f)-1(e)) or the foreign source taxable income for the year in the same separate category as the loss account. If, in any year, in accordance with section 164(a) and section 275(a)(4)(A), a taxpayer deducts rather than credits its foreign taxes, recapture is applied to the extent of the lesser of—

(i) The balance in the overall foreign loss account in each separate category; or

(ii) Foreign source taxable income minus foreign taxes in each separate category.

(c)(2) through (5) *Example 3* [Reserved] For further guidance, see § 1.904(f)-2(c)(2) through (5) *Example 3*.

*Example 4.* Y Corporation is a domestic corporation that does business in the United States and abroad. On December 31, 2007, the balance in Y's general category overall foreign loss account is \$500, all of which is attributable to a loss incurred in 2007. Y has no other loss accounts subject to recapture. For 2008, Y has U.S. source taxable income of \$400 and foreign source taxable income of \$300 in the general category and \$900 in the passive category. Under paragraph (c)(1) of this section, the amount of Y's general category income subject to recharacterization is the lesser of the aggregate maximum potential recapture or 50 percent of the total foreign source taxable income. In this case Y's aggregate maximum potential recapture is \$300 (the lesser of the \$500 balance in the general category overall foreign loss account or \$300 foreign source income in the general category for the year), which is less than \$600, or 50 percent of total foreign source taxable income ( $\$1200 \times 50\%$ ). Therefore, pursuant to paragraph (c) of this section, \$300 of foreign

source income in the general category is recharacterized as U.S. source income. The balance in Y's general category overall foreign loss account is reduced by \$300 to \$200 in accordance with § 1.904(f)-1(e)(2).

(c)(5) *Example 5* through (d) [Reserved] For further guidance, see § 1.904(f)-2(c)(5) *Example 5* through § 1.904(f)-2(d).

(e) *Effective/applicability date.* This section applies to taxable years beginning after December 21, 2007.

(f) *Expiration date.* The applicability of this section expires on December 20, 2010.

[T.D. 9371, 72 FR 72597, Dec. 21, 2007]

#### § 1.904(f)-3 Allocation of net operating losses and net capital losses.

For rules relating to the allocation of net operating losses and net capital losses, see § 1.904(g)-3T.

[T.D. 9371, 72 FR 72598, Dec. 21, 2007]

#### § 1.904(f)-4 Recapture of foreign losses out of accumulation distributions from a foreign trust.

(a) *In general.* If a taxpayer receives a distribution of foreign source taxable income subject to a separate limitation in which the taxpayer had a balance in an overall foreign loss account and that income is treated under section 666 as having been distributed by a foreign trust in a preceding taxable year, a portion of the balance in the taxpayer's applicable overall foreign loss account shall be subject to recapture under this section. The amount subject to recapture shall be the lesser of the balance in the taxpayer's overall foreign loss account (after applying §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, and 1.904(f)-6 to the taxpayer's other income or loss in the current taxable year) or the entire amount of foreign source taxable income deemed distributed in a preceding year or years under section 666.

(b) *Effect of recapture on foreign tax credit limitation under section 667(d).* If paragraph (a) of this section is applicable, then in applying the separate limitation (in accordance with section 667(d)(1) (A) and (C)) to determine the amount of foreign taxes deemed distributed under section 666 (b) and (c) that can be credited against the increase in tax in a computation year, a

portion of the foreign source taxable income deemed distributed in such computation year shall be treated as United States source income. Such portion shall be determined by multiplying the amount of foreign source taxable income deemed distributed in the computation year by a fraction. The numerator of this fraction is the balance in the taxpayer's overall foreign loss account (after application of §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, and 1.904(f)-6), and the denominator of the fraction is the entire amount of foreign source taxable income deemed distributed under section 666. However, the numerator of this fraction shall not exceed the denominator of the fraction.

(c) *Recapture if taxpayer deducts foreign taxes deemed distributed.* If paragraph (a) of this section is applicable and if, in accordance with section 667(d)(1)(B), the beneficiary deducted rather than credited its taxes in the computation year, the beneficiary shall reduce its overall foreign loss account (but not below zero) by an amount equal to the lesser of the balance in the applicable overall foreign loss account or the amount of the actual distribution deemed distributed in the computation year (without regard to the foreign taxes deemed distributed).

(d) *Illustrations.* The provisions of this section are illustrated by the following examples:

*Example 1.* X Corporation is a domestic corporation that has a balance of \$10,000 in its general limitation overall foreign loss account on December 31, 1980. For its taxable year beginning January 1, 1981, X's only income is an accumulation distribution from a foreign trust of \$20,000 of general limitation foreign source taxable income. Under section 666, the amount distributed and the foreign taxes paid on such amount (\$4,000) are deemed distributed in two prior taxable years. In determining the partial tax on such distribution under section 667(b), the amount added to each computation year is \$12,000 (the sum of the actual distribution plus the taxes deemed distributed (\$24,000) divided by the number of accumulation years (2)). Of that amount, \$5,000 ( $\$10,000/\$24,000 \times \$12,000$ ) is treated as United States source taxable income in accordance with paragraph (b) of this section. Assuming the United States tax rate is 50 percent, X's separate foreign tax credit limitation against the increase in tax in each computation year is \$3,500 ( $\$7,000/$

$\$12,000 \times \$6,000$ ) instead of \$6,000 ( $\$12,000/\$12,000 \times \$6,000$ ). X's overall foreign loss account is reduced to zero in accordance with paragraph (a) of this section.

*Example 2.* Assume the same facts as in Example 1, except that X deducted rather than credited its foreign taxes in the computation years. In 1979, the amount added to X's income is \$12,000 under section 667(b), \$2,000 of which is deductible under section 667(d)(1)(B). X must reduce its overall foreign loss account by \$10,000, the amount of the actual distribution that is deemed distributed in 1979 (without regard to the \$2,000 foreign taxes also deemed distributed). The entire overall foreign loss account is therefore reduced to \$0 in 1979.

[T.D. 8153, 52 FR 32002, Aug. 25, 1987]

**§ 1.904(f)-5 Special rules for recapture of overall foreign losses of a domestic trust.**

(a) *In general.* Except as provided in this section, the rules contained in §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, 1.904(f)-4, and 1.904(f)-6 apply to domestic trusts.

(b) *Recapture of trust's overall foreign loss.* In taxable years in which a trust has foreign source taxable income subject to a separate limitation in which the trust has a balance in its overall foreign loss account, the balance in the trust's overall foreign loss account shall be recaptured as follows:

(1) *Trust accumulates income.* If the trust accumulates all of its foreign source taxable income subject to the same limitation as the loss that created the balance in the overall foreign loss account, its overall foreign loss shall be recaptured out of such income in accordance with §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, 1.904(f)-4, and 1.904(f)-6.

(2) *Trust distributes income.* If the trust distributes all of its foreign source taxable income subject to the same limitation as the loss that created the overall foreign loss account, the amount of the overall foreign loss that would be subject to recapture by the trust under paragraph (b)(1) of this section shall be allocated to the beneficiaries in proportion to the amount of such income which is distributed to each beneficiary in that year.

(3) *Trust accumulates and distributes income.* If the trust accumulates part of its foreign source taxable income subject to the same limitation as the loss