

gross income in accordance with sections 861(b) and 865 and the regulations thereunder, including §§1.861-8 through 1.861-14T.

(d) *Additions to overall domestic loss accounts*—(1) *General rule.* A taxpayer's overall domestic loss as determined under paragraph (c) of this section shall be added to the applicable overall domestic loss account at the end of its taxable year to the extent that the overall domestic loss either reduces foreign source income for the year (but only if such year is a qualified taxable year) or reduces foreign source income for a qualified taxable year to which the loss has been carried back.

(2) *Overall domestic loss of another taxpayer.* If any portion of any overall domestic loss of another taxpayer is allocated to the taxpayer in accordance with §1.1502-9 (relating to consolidated overall domestic losses) the taxpayer shall add such amount to its applicable overall domestic loss account.

(3) *Adjustments for capital gains and losses.* If the taxpayer has capital gains or losses or qualified dividend income, the amount by which a domestic loss is considered to reduce foreign source income in a taxable year shall equal the section 904(f)(5)(D) amount determined under §1.904(b)-1(h)(1)(iii), regardless of the amount of domestic loss that was determined before taking any section 904(b)(2) adjustments into account.

(e) *Reductions of overall domestic loss accounts.* The taxpayer shall subtract the following amounts from its overall domestic loss accounts at the end of its taxable year in the following order, as applicable:

(1) *Pre-recapture reduction for amounts allocated to other taxpayers.* An overall domestic loss account is reduced by the amount of any overall domestic loss which is allocated to another taxpayer in accordance with §1.1502-9 (relating to consolidated overall domestic losses).

(2) *Reduction for amounts recaptured.* An overall domestic loss account is reduced by the amount of any U.S. source income that is recharacterized in accordance with §1.904(g)-2(c) (relating to recapture under section 904(g)(1)).

(f) *Effective/applicability date.* This section applies to taxpayers that sus-

tain an overall domestic loss for a taxable year beginning on or after January 1, 2012. Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, including periods covered by 26 CFR §1.904(g)-1T (revised as of April 1, 2010).

[T.D. 9595, 77 FR 37580, June 22, 2012]

**§ 1.904(g)-2 Recapture of overall domestic losses.**

(a) *In general.* A taxpayer shall recapture an overall domestic loss as provided in this section. Recapture is accomplished by treating a portion of the taxpayer's U.S. source taxable income as foreign source income. The recharacterized income is allocated among and increases foreign source income in separate categories in proportion to the balances of the overall domestic loss accounts with respect to those separate categories. As a result, if the taxpayer chooses the benefits of section 901, the taxpayer's foreign tax credit limitation is increased. As provided in §1.904(g)-1(e)(2), the balance in a taxpayer's overall domestic loss account with respect to a separate category is reduced at the end of each taxable year by the amount of loss recaptured during that taxable year. Recapture continues until the amount of U.S. source income recharacterized as foreign source income equals the amount in the overall domestic loss account.

(b) *Determination of U.S. source taxable income for purposes of recapture.* For purposes of determining the amount of an overall domestic loss subject to recapture, the taxpayer's taxable income from U.S. sources shall be computed in accordance with the rules set forth in §1.904(g)-1(c)(4). U.S. source taxable income shall be determined by taking into account adjustments for capital gains and losses and qualified dividend income in a similar manner to the adjustments made to foreign source taxable income under section 904(b)(2) and §1.904(b)-1, following the principles of §1.904(b)-1(h)(1)(i).

(c) *Section 904(g)(1) recapture.* The amount of any U.S. source taxable income subject to recharacterization in a taxable year in which paragraph (a) of this section applies is the lesser of the

aggregate balance of the taxpayer's overall domestic loss accounts or 50 percent of the taxpayer's U.S. source taxable income (as determined under paragraph (b) of this section).

(d) *Effective/applicability date.* This section applies to taxpayers that sustain an overall domestic loss for a taxable year beginning on or after January 1, 2012. Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, including periods covered by 26 CFR 1.904(g)-2T (revised as of April 1, 2010).

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**§ 1.904(g)-3 Ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for the recapture of separate limitation losses, overall foreign losses, and overall domestic losses.**

(a) *In general.* This section provides ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for the recapture of separate limitation losses, overall foreign losses, and overall domestic losses. The rules must be applied in the order set forth in paragraphs (b) through (i) of this section.

(b) *Step One: Allocation of net operating loss and net capital loss carryovers*—(1) *In general.* Net operating losses from a current taxable year are carried forward or back to a taxable year in the following manner. Net operating losses that are carried forward pursuant to section 172 are combined with income or loss in the carryover year in the manner described in this paragraph (b). The combined amounts are then subject to the ordering rules provided in paragraphs (c) through (i) of this section. Net operating losses that are carried back to a prior taxable year pursuant to section 172 are allocated to income in the carryback year in the manner set forth in paragraphs (b)(2), (b)(3), (c), (d), and (e) of this section. The income in the carryback year to which the net operating loss is allocated is the foreign source income in each separate category and the U.S. source income after the application of sections 904(f) and 904(g) to income and

loss in that previous year, including as a result of net operating loss carryovers or carrybacks from taxable years prior to the current taxable year.

(2) *Full net operating loss carryover.* If the full net operating loss (that remains after carryovers to other taxable years) is less than or equal to the taxable income in a particular taxable year (carryover year), and so can be carried forward in its entirety to such carryover year, U.S. source losses and foreign source losses in separate categories that are part of a net operating loss from a particular taxable year that is carried forward in its entirety shall be combined with the U.S. source income or loss and the foreign source income or loss in the same separate categories in the carryover year.

(3) *Partial net operating loss carryover.* If the full net operating loss (that remains after carryovers to other taxable years) exceeds the taxable income in a carryover year, and so cannot be carried forward in its entirety to such carryover year, the following rules apply:

(i) Any U.S. source loss (not to exceed the net operating loss carryover) shall be carried over to the extent of any U.S. source income in the carryover year.

(ii) If the net operating loss carryover exceeds the U.S. source loss carryover determined under paragraph (b)(3)(i) of this section, then separate limitation losses that are part of the net operating loss shall be tentatively carried over to the extent of separate limitation income in the same separate category in the carryover year. If the sum of the potential separate limitation loss carryovers determined under the preceding sentence exceeds the amount of the net operating loss carryover reduced by any U.S. source loss carried over under paragraph (b)(3)(i) of this section, then the potential separate limitation loss carryovers shall be reduced pro rata so that their sum equals such amount.

(iii) If the net operating loss carryover exceeds the sum of the U.S. and separate limitation loss carryovers determined under paragraphs (b)(3)(i) and (ii) of this section, then a proportionate part of the remaining loss from each separate category shall be carried over to the extent of such excess and