



# Instructions for Form 1116

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

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

### General Instructions

#### A Change To Note

**Foreign source qualified dividends.** Because of lower U.S. tax rates on qualified dividends paid after December 31, 2002, you may have to make certain adjustments to your foreign source qualified dividends before entering them on line 1 of Form 1116. For more information, see **Foreign Qualified Dividends and Capital Gains (Losses)**, starting on page 6.

#### 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 (lines 14 through 20 of the form) will not apply to you. This election is available **only** if you meet **all** of the following conditions.

- All of 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 starting on page 4, **(b)** income that would be passive except that it is also described in another category, and **(c)** certain export financing interest.

- 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 13.

To make the election, just enter on the foreign tax credit line of your tax return (for example, Form 1040, line 44) the **smaller** of **(a)** your total foreign tax or **(b)** your regular tax (for example, Form 1040, line 41).

#### 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.

#### Tax Help

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

##### IRS Contacts

- In the U.S. 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 Berlin, London, Paris, Rome, 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.

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. Form 1040 filers choosing to do so would 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 this page.
- 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 this page.
- Certain taxes paid or accrued to a foreign country in connection with the purchase or sale of oil or gas extracted in that country, as described in item 6 under **Foreign Taxes Not Eligible for a Credit** on this page.

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 your 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 near the back of 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) or Pub. 514.

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 (or on the day the tax was withheld). 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.

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

For item **2** above, 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.

If any of the above 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.

**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.

**Tax years beginning before 1998.** For the rules relating to redetermining U.S. 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 redetermined foreign tax instead of filing Form 1040X or other amended return.

## Income From Sources Outside the United States

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

- 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.
- 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 received from a controlled foreign corporation (CFC) in which you are a U.S. shareholder who owns 10% or more of the total voting power of all classes of the corporation's 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 (domestic international sales corporation) 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 (foreign sales corporation) 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 lump-sum 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**, below, to figure the amounts to enter in Part III.

**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 (a) it is 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.

**Worksheet for Lump-Sum Distributions**

(Keep for Your Records)

1. Enter the amount from Form 1116, line 8 . . . . . 1. \_\_\_\_\_
  2. Enter the sum of the amounts from Form 4972, lines 6 and 12, that are from **foreign** sources. Also enter this amount on Form 1116, line 16 . . . . . 2. \_\_\_\_\_
  3. Enter the sum of the amounts from Form 4972, lines 6 and 12, that are from **all** sources (both U.S. and foreign). 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 four 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 30. Also include this amount on Form 1116, line 19 . . . . . 5. \_\_\_\_\_
- Caution: Do not include the amount on line 5 above 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 . . . . . 6. \_\_\_\_\_
  7. Enter the **smaller** of line 1 or line 6 here and on Form 1116, line 21. To the left of line 21, write "LSD" . . . . . 7. \_\_\_\_\_

## 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 2003 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 6 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 each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received from 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 the following.*

- *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 in Part I of Form 1116 income that you determined (using the above rules) to be U.S. source income.



*If the partnership or S corporation has specifically identified any capital gains or losses or unrecaptured section 1250 gain on this line (Schedule K-1, line 17c or 15c) and you have determined that those gains or losses are foreign source, see **Foreign Qualified Dividends and Capital Gains (Losses)** starting on page 6 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 each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).

**Note:** *You should disregard any information shown on your Schedule K-1 pertaining to gross income attributable to a foreign branch. 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 12 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 each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).

**Note:** *You should disregard any information shown on your Schedule K-1 pertaining to definitely allocable deductions attributable to a foreign branch. It is intended only for corporate partners preparing Form 1116.*

**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 each of the applicable Forms 1116 (that is, those Forms 1116 for each category of income you received).

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

### **Foreign Qualified Dividends and Capital Gains (Losses)**

If you have foreign source qualified dividends or foreign source capital gains (including any foreign source capital gain distributions) or losses, you may be required to make certain adjustments to those amounts before taking them into account on line 1 (qualified dividends and gains) or line 5 (losses). You may use the instructions in this section to determine those adjustments. If you choose not to use the rules outlined in this section, see sections 1(h)(11)(C)(iv) and 904(b)(2) to determine the adjustments you must make.

If you completed the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for your tax return, see **Qualified Dividends and Capital Gain Tax Worksheet (Individuals)**, next, to determine the adjustments you may

be required to make. If you completed the **Qualified Dividends Tax Worksheet** in the instructions for Form 1041, see **Qualified Dividends Tax Worksheet (Estates and Trusts)**, below, to determine the adjustments you may be required to make. If you are filing a Schedule D with your return, see **Schedule D**, on the next page, to determine the adjustments you may be required to make.

### **Qualified Dividends and Capital Gain Tax Worksheet (Individuals)**

If you completed the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for your tax return, you must adjust the amount of your foreign source qualified dividends and capital gain distributions if:

- Line 7 of the **Qualified Dividends and Capital Gain Tax Worksheet** is equal to or more than line 8 of that worksheet **and**
- Line 27 of the **Qualified Dividends and Capital Gain Tax Worksheet** is less than line 28 of that worksheet.

To adjust your foreign source qualified dividends, multiply your foreign source qualified dividends in each separate category by 0.4286. Include the results on line 1 of the applicable Form 1116.



*Do not adjust the amount of any foreign source qualified dividends that you elected to include on line 4g of Form 4952.*

To adjust your foreign source capital gain distributions, multiply your post-May 5 foreign source capital gain distributions in each separate category by 0.4286. Multiply your other foreign source capital gain distributions in each separate category by 0.5714. Include the results on line 1 of the applicable Form 1116.

If you are not required to adjust the amount of your foreign source qualified dividends or capital gain distributions, include the amount of your foreign source qualified dividends and capital gain distributions in each separate category (without adjustment) on line 1 of the applicable Form 1116.

### **Qualified Dividends Tax Worksheet (Estates and Trusts)**

If you completed the **Qualified Dividends Tax Worksheet** in the instructions for Form 1041, you must adjust the amount of your foreign source qualified dividends if:

- Line 5 of the **Qualified Dividends Tax Worksheet** is equal to or more than line 6 of that worksheet **and**

• Line 15 of the Qualified Dividends Tax Worksheet is less than line 16 of that worksheet.

To adjust your foreign source qualified dividends, multiply your foreign source qualified dividends in each separate category by 0.4286. Include the results on line 1 of the applicable Form 1116.

If you are not required to make adjustments to your foreign source qualified dividends, include your foreign source qualified dividends on line 1 of the applicable Form 1116 without adjustment.



*Do not adjust the amount of any foreign source qualified dividends that you elected to include on line 4g of Form 4952.*

### Schedule D

**Note:** Throughout these instructions, references to **Schedule D (Form 1041)** are for estates and trusts only.

**Adjustments to foreign qualified dividends.** If you are filing Schedule D (Form 1040 or Form 1041) with your tax return, you must adjust the amount of your foreign source qualified dividends that you include on line 1 of Form 1116 if **either** of the following applies to you.

1. You figured your tax using Part IV of **Schedule D (Form 1040)**, line 27 of Schedule D (Form 1040) is equal to or greater than line 28, **and** line 51 of Schedule D (Form 1040) is less than line 52. (For estates and trusts, line 24 of Schedule D (Form 1041) is equal to or greater than line 25 **and** line 48 is less than line 49.)

2. You figured your tax using the **Schedule D Tax Worksheet** (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions), line 17 of the Schedule D Tax Worksheet is equal to or greater than line 15, **and** line 49 of the Schedule D Tax Worksheet is less than line 50.

To adjust your foreign source qualified dividends, multiply your foreign source qualified dividends in each separate category by 0.4286. Include the results on line 1 of the applicable Form 1116.



*Do not adjust the amount of any foreign source qualified dividends that you elected to include on line 4g of Form 4952.*

Include on line 1 of Form 1116 the full amount of foreign source qualified dividends that you are not required to adjust.

**Adjustments to foreign capital gains and losses.** You may use **Worksheet A**, **Worksheet B**, or the instructions for **Capital Gains and Losses** in Pub. 514 to determine the

adjustments you must make to your foreign capital gains or losses. Use the instructions below to see if you qualify to use Worksheet A or Worksheet B. If you do not qualify to use Worksheet A or Worksheet B, or you choose not to use the worksheets, use the instructions for **Capital Gains and Losses** in Pub. 514 to determine the adjustments you must make.



*Before you complete Worksheet A or Worksheet B, you must reduce each foreign source long-term capital gain by the amount of that gain you elected to include on line 4g of Form 4952. The gain you elected to include on line 4g of Form 4952 must be entered directly on line 1 of the applicable Form 1116 without adjustment.*

**Worksheet A.** You may use Worksheet A on page 8 to determine the adjustments you must make to your foreign source capital gains or losses if you have foreign source capital gains or losses in no more than two separate categories and **any** of the following apply.

- Line 16 or 17a of the Schedule D (Form 1040) (or line 13 or 16a of the Schedule D (Form 1041)) you are filing with your tax return is zero or a loss.
- Line 27 of the Schedule D (Form 1040) you are filing with your tax return is less than line 28 of that Schedule D. (For estates and trusts, line 24 of the Schedule D (Form 1041) you are filing with your tax return is less than line 25 of that Schedule D.)
- Line 52 of the Schedule D (Form 1040) you are filing with your tax return is equal to or less than line 51 of that Schedule D. (For estates and trusts, line 49 of the Schedule D (Form 1041) you are filing with your tax return is equal to or less than line 48 of that Schedule D.)
- You figured your tax using the Schedule D Tax Worksheet (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions) and line 17 of the Schedule D Tax Worksheet is smaller than line 15 **or** line 50 of the Schedule D Tax Worksheet is the same as or smaller than line 49.

Complete Worksheet A only once, even if you have capital gains or losses in two separate categories. Retain the completed Worksheet A for your files. Do not file Worksheet A with your tax return.

**Worksheet B.** If you do not qualify to use Worksheet A, use Worksheet B on page 9 to determine the adjustments you must make to your

foreign source capital gains or losses if:

- You have foreign source capital gains or losses in only one separate category, **and**
- You did not complete the **Unrecaptured Section 1250 Gain Worksheet** or the **28% Rate Gain Worksheet** in the Schedule D instructions.

Retain the completed Worksheet B for your files. Do not file Worksheet B with your tax return.

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## 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.*

#### 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 on line 1 wages **not** excluded

	Category #1	Category #2
Specify ►	_____	_____
1. Separate category capital gain or (loss) . . . . .	1. _____	_____
2. Foreign source capital gain net income . . . . .		2. _____
3. Capital gain net income . . . . .		3. _____
4. Total U.S. capital loss adjustment . . . . .		4. _____
5. Adjusted separate category capital gain . . . . .		5. _____
6. U.S. capital loss adjustment factor. (For each separate category, divide line 1 by line 2 and round off the result to at least four decimal places.) . . . . .	6. _____	_____
7. U.S. capital loss adjustment. (For each separate category, multiply line 4 by line 6.) . . . . .	7. _____	_____
8. Adjusted separate category capital gain. (For each separate category, subtract line 7 from line 1. Enter the result here and include the result on line 1 of the applicable Form 1116.) . . . . .	8. _____	_____

**Instructions for Worksheet A**

**Line 1.** For each separate category for which you have foreign source capital gains or losses, combine your foreign source capital gains and losses in that separate category and enter the result on line 1. Show a loss on line 1 of this worksheet as a negative amount and include the loss on line 5 of the Form 1116 you are filing for that separate category.

**Line 2.** Combine the amounts entered on line 1. If the result is zero or less, do not complete the rest of the worksheet. Instead, for each separate category with a positive amount on line 1 of this worksheet, include that positive amount on line 1 of the Form 1116 you are filing for that separate category.

**Line 3.** Enter the amount from line 17a of the Schedule D (Form 1040) you are filing with your tax return, less any amount shown on line 25 of that Schedule D. If the result is zero or less, enter -0-.

**Estates and trusts:** Enter the amount from line 16a of the Schedule D (Form 1041) you are filing with your tax return, less any amount shown on line 22 of that Schedule D. If the result is zero or less, enter -0-.

**Line 4.** Subtract line 3 from line 2 and enter the result on line 4. If the result is zero or less, do not complete the rest of the worksheet. Instead, for each separate category with a positive amount on line 1 of this worksheet, include that positive amount on line 1 of the Form 1116 you are filing for that separate category.

**Line 5.**

- If both separate categories have a positive amount on line 1, skip line 5 and go to line 6.
- If only one separate category has a positive amount on line 1, subtract line 4 from that positive amount. Enter the result here and include the result on line 1 of the Form 1116 you are filing for that separate category. **Stop here.**



on Form 2555 or Form 2555-EZ, 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 foreign source qualified dividends or foreign source capital gains or losses, see *Foreign Qualified Dividends and Capital Gains (Losses)* starting on page 6.**

## 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 Regulations section 1.861-17.

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 deductions on line 28 of Schedule A (Form 1040) because your adjusted gross income was more than \$139,500 (\$69,750 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 four 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 \$199,500. 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.

## Worksheet B (See instructions below)

(Keep for Your Records)

	(1) Short-Term	(2) Long-Term (Post-May 5)	(3) Long-Term (Other)
1. Separate category rate group capital gain or (loss).			
2. U.S. capital loss adjustment amount.			
3. Subtotal (subtract line 2 from line 1).			
4. Adjusted separate category capital gains and losses.			

### Instructions for Worksheet B

**Line 1.** Combine your foreign source short-term capital gains and losses and enter the result in column (1). Combine your post-May 5 long-term capital gains and losses from foreign sources and enter the result in column (2) of line 1. Combine your remaining long-term capital gains and losses from foreign sources and enter the result in column (3) of line 1.

**Line 2.** Complete the **Line 2 Worksheet** on the next page for each column on line 1 with a gain.

**Line 4.** If you have a:

- Short-term gain shown in column (1) of line 3, enter the amount of that short-term gain on line 4 (column (1)).
- Post-May 5 long-term gain shown in column (2) of line 3, multiply the amount of that gain by 0.4286 and enter the result on line 4 (column (2)).
- Long-term gain shown in column (3) of line 3, multiply the amount of that gain by 0.5714 and enter the result on line 4 (column (3)).
- Loss in any column of line 3, complete the **Line 4 Worksheet** on page 11 for each column with a loss.

After you have completed line 4:

- Include line 4 gain amounts on line 1 of the applicable Form 1116.
- Include line 4 loss amounts on line 5 of the applicable Form 1116.

**Line 2 Worksheet (For Line 2 of Worksheet B)**  
 (See instructions below)

(Keep for Your Records)

**Category**

Specify ► \_\_\_\_\_

1. Separate category rate group capital gain . . . . .	1.	Short-Term	Long-Term (Post-May 5)	Long-Term (Other)	
2. Foreign source capital gain net income . . . . .	2.				
3. Capital gain net income . . . . .	3.				
4. Total U.S. capital loss adjustment . . . . .	4.				
5. Foreign source capital gain . . . . .	5.				
6. U.S. capital loss adjustment factor. (Divide each amount on line 1 by line 5 and enter the result here. Round off each result to at least four decimal places.) . . . . .	6.				
7. U.S. capital loss adjustment. (Multiply line 4 by line 6. Enter the results here and on line 2 of Worksheet B.) . . . . .	7.				

**Instructions for Line 2 Worksheet**

**Line 1.** Enter only positive amounts (gains) from line 1 of Worksheet B.

**Line 2.** Combine the amounts from line 1 of Worksheet B and enter the result on line 2 of this worksheet. If the result is zero or less, **stop here**. Do **not** enter any amount on line 2 of Worksheet B.

**Line 3.** Enter the amount from line 17a of the Schedule D (Form 1040) you are filing with your tax return, less any amount shown on line 25 of that Schedule D. If the amount entered on line 3 is zero or less, **stop here**. Do not continue with this worksheet or Worksheet B. Instead, complete Worksheet A.

**Estates and trusts:** Enter the amount from line 16a of the Schedule D (Form 1041) you are filing with your tax return, less any amount shown on line 22 of that Schedule D. If the amount entered on line 3 is zero or less, **stop here**. Do not continue with this worksheet or Worksheet B. Instead, complete Worksheet A.

**Line 4.** Subtract line 3 from line 2 and enter the result on line 4. If the result is zero or less, **stop here**. Do not enter any amount on line 2 of Worksheet B.

**Line 5.**

- If more than one column of this worksheet has an amount on line 1, add all of the amounts from line 1 and enter the result on line 5 of this worksheet.
- If only one column has an amount on line 1, enter the amount from line 4 of this worksheet on line 2 of Worksheet B (in that same column) and **stop here**.

**Line 4 Worksheet (For line 4 of Worksheet B)**

*(Keep for Your Records)*

1. Enter the total amount of long-term capital gains (for Form 1041 filers, enter the estate's or trust's allocable share of long-term capital gains). Ignore any long-term capital losses . . . . . **1.** \_\_\_\_\_
2. Enter the total amount of post-May 5 long-term capital gains (for Form 1041 filers, enter the estate's or trust's allocable share of post-May 5 long-term capital gains). Ignore any post-May 5 long-term capital losses . . . . . **2.** \_\_\_\_\_
3. Subtract line 2 from line 1 . . . . . **3.** \_\_\_\_\_
4. Divide line 2 by line 1. If line 2 is zero, enter -0- . . . . . **4.** \_\_\_\_\_
5. Divide line 3 by line 1. If line 3 is zero, enter -0- . . . . . **5.** \_\_\_\_\_
6. Enter the total amount of losses shown on Worksheet B, line 3, columns 2 and 3 as a positive amount . . . . . **6.** \_\_\_\_\_
7. Multiply line 6 by line 4. Multiply the result by 0.4286 and enter the result here . . . . . **7.** \_\_\_\_\_
8. Multiply line 6 by line 5. Multiply the result by 0.5714 and enter the result here . . . . . **8.** \_\_\_\_\_
9. Add lines 7 and 8. Enter the result here and in column 2 of line 4 on Worksheet B as a negative amount . . . . . **9.** \_\_\_\_\_
10. If you have a loss on line 7b of your Schedule D (Form 1040) (or line 5b of your Schedule D (Form 1041)), enter that amount here as a positive amount. If you have a gain on line 7b of your Schedule D (Form 1040) (or line 5b of your Schedule D (Form 1041)), do not continue with the rest of this worksheet. Instead, if you entered a loss on Worksheet B, line 3, column 1, enter that loss as a negative amount on Worksheet B, line 4, column 1 . . . **10.** \_\_\_\_\_
11. Enter the amount of the loss, if any, you entered on Worksheet B, line 1, column 1 as a positive amount. If you did not enter a loss, **stop here** . . . . . **11.** \_\_\_\_\_
12. Enter the smaller of line 10 or line 11. If lines 10 and 11 are the same amount, enter that amount . . . . . **12.** \_\_\_\_\_
13. Multiply line 12 by line 4. Multiply the result by 0.4286 and enter the result here . . . . . **13.** \_\_\_\_\_
14. Multiply line 12 by line 5. Multiply the result by 0.5714 and enter the result here . . . . . **14.** \_\_\_\_\_
15. Subtract line 12 from line 11. If the amount is greater than zero, enter that amount here. Otherwise, leave line 15 blank . . . . . **15.** \_\_\_\_\_
16. Add lines 13, 14, and 15. Enter the result here and on Worksheet B, line 4, column 1 as a negative amount . . . . . **16.** \_\_\_\_\_

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 (\$7,280) to enter on line 2.

**Line 2**



*Before you complete line 2, read **Itemized deduction limit** starting on page 9.*

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.

**Lines 3a and 3b**

Some deductions do not definitely relate to either your foreign source income or 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** starting on page 9.

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 paid from Form 1040, line 32a).

**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. Include any foreign earned income you have excluded on Form 2555 or Form 2555-EZ.

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 four 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 below to figure the amount to enter on line 4a. Before you complete the worksheet, read **Itemized deduction limit** starting on page 9.

**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." See Pub. 514 for more information.

**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.

**Line 5**

If you have capital losses from foreign sources, see **Foreign Qualified Dividends and Capital Gains (Losses)** on page 6 for information on adjustments you may be required to make.

**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

**Worksheet for Home Mortgage Interest—Line 4a**

(Keep for Your Records)

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

- 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 four 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 the appropriate 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.

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 back to a tax year for which you claimed a deduction, rather than a credit, for foreign taxes paid or accrued. However, 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 and housing amounts you **excluded** for the tax year minus otherwise deductible expenses (not including the foreign housing deduction) allocable to that income.

*Denominator:* Your **total** foreign earned income received or accrued during the tax year minus deductible expenses (including the foreign housing deduction) 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 minus 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 American Samoa, 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 41) 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, and attach all supporting schedules. In addition, you must reduce either the total taxes available for credit or the credit otherwise allowable by your foreign taxes resulting from boycott activities. 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 (figured on **Schedule A (Form 5713)**, 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 taxable income (or loss), before adjustments, from sources outside the United States. If the amount on line 14 is zero or a loss, 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 a loss.

### 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 more details on each of these adjustments.

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 any remaining loss to reduce U.S. source income.

If the loss reduces foreign source income, you must recharacterize the income you receive in the loss category in later years. See **Recharacterization of income** beginning on this page. 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** on this page.

**Example.** For 2003, 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. Include the \$1,600 (in parentheses) 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. Include the \$400 (in parentheses) 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.

If you receive general limitation income in a later year, you must recharacterize all or part of that income as passive income and high withholding tax interest in that later year. See the example under **Recharacterization of income** on this page.

**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, if you choose) 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** on this page.

**Reduce** the income on line 14 by including (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 (**b**

above), 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 may be 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 including (in parentheses) on line 15 the smallest 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, or **(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 2003 all or part of any income you receive in 2003 in that loss category. You recharacterize the income by:

- **Increasing** the amount on line 14 (adjusted by any of the other adjustments previously mentioned in these line 15 instructions) of the Form 1116 for each of the other categories previously reduced by including on line 15 any recharacterized income and
- **Decreasing** the amount on line 14 (adjusted by any of the other adjustments previously mentioned in these line 15 instructions) of the Form 1116 for the loss category by including on line 15 the amount of recharacterized income as a negative number (in parentheses).

Also include on line 15 income that must be recharacterized in 2003 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** on page 14, in the next year (2004), 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 2003, \$1,600 of your 2004 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 2004 Form 1116 for passive income, you would include \$1,600 on line 15. On your 2004 Form 1116 for high withholding tax interest, you would include \$400 on line 15. On your 2004 Form 1116 for general limitation income, you would include (\$2,000) 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 2003, proportionately allocate that loss among the separate categories of your foreign income. **Reduce** the income on line 14 (adjusted by any of the other adjustments previously mentioned in these line 15 instructions) by including (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. A U.S. loss does not include any U.S. net capital loss to the extent the U.S. net capital loss has already reduced foreign capital gains under **Adjustments to foreign capital gains and losses** on page 7. A U.S. net capital loss reduced foreign capital gains to the extent of any amount entered on line 4 of **Worksheet A** on page 8 or on line 4 of the **Line 2 Worksheet** on page 10.

**Line 17**

If you have qualified dividends or capital gains, you may be required to make adjustments to those qualified dividends and gains before you take those amounts into account on line 17. You may use the instructions in this section to determine those adjustments. If you choose not to use the rules outlined in this section, see sections 1(h)(11)(C)(iv) and 904(b)(2) to determine the adjustments you must make.

**Individuals Who Completed a Qualified Dividends and Capital Gain Tax Worksheet**

If you completed the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for your tax return, you must use the **Worksheet for Line 17** on this page to figure the amount to enter on line 17 if:

- Line 7 of your Qualified Dividends and Capital Gain Tax Worksheet is equal to or more than line 8 of that worksheet **and**

- Line 27 of your Qualified Dividends and Capital Gain Tax Worksheet is less than line 28 of that worksheet.

If you do not need to complete the Worksheet for Line 17, enter on line 17 of Form 1116 your taxable income without the deduction for your exemption (for example, the amount from Form 1040, line 38).

If you **do** need to complete the Worksheet for Line 17, do the following.

**Lines 2 through 5.** Skip these lines.

**Line 6.** Enter the amount from line 24 of the Qualified Dividends and Capital Gain Tax Worksheet.

**Line 8.** Enter the amount from line 22 of the Qualified Dividends and Capital Gain Tax Worksheet.

Complete all other lines as instructed on the worksheet.

**Estates and Trusts That Completed a Qualified Dividends Tax Worksheet**

If you completed the Qualified Dividends Tax Worksheet in the instructions for Form 1041, you must use the **Worksheet for Line 17** on this page to figure the amount to enter on line 17 if:

- Line 5 of your Qualified Dividends Tax Worksheet is equal to or more than line 6 of that worksheet **and**
- Line 15 of your Qualified Dividends Tax Worksheet is less than line 16 of that worksheet.

If you do not need to complete the Worksheet for Line 17, enter on line 17 of Form 1116 the estate's or

**Worksheet for Line 17 (Worldwide Qualified Dividends and Capital Gains)**

*(Keep for Your Records)*

**Caution:** See the instructions for **Line 17** beginning on this page before starting this worksheet.

- |  |           |
|--|-----------|
| 1. <b>Individuals:</b> Enter the amount from Form 1040, line 38. If you are a nonresident alien, enter the amount from Form 1040NR, line 36. |           |
| <b>Estates and trusts:</b> Enter taxable income without the deduction for your exemption . . . . .   | 1. _____  |
| 2. Enter your worldwide 28% gains (see instructions) . . . . .   | 2. _____  |
| 3. Multiply line 2 by 0.2000 . . . . .   | 3. _____  |
| 4. Enter your worldwide 25% gains (see instructions) . . . . .   | 4. _____  |
| 5. Multiply line 4 by 0.2857 . . . . .   | 5. _____  |
| 6. Enter your worldwide 20% gains (see instructions) . . . . .   | 6. _____  |
| 7. Multiply line 6 by 0.4286 . . . . .   | 7. _____  |
| 8. Enter your worldwide 15% gains and qualified dividends (see instructions) . . . . .   | 8. _____  |
| 9. Multiply line 8 by 0.5714 . . . . .   | 9. _____  |
| 10. Add lines 3, 5, 7, and 9 . . . . .   | 10. _____ |
| 11. Subtract line 10 from line 1. Enter the result here and on Form 1116, line 17 . . . . .  | 11. _____ |

trust's taxable income without the deduction for its exemption.

If you **do** need to complete the Worksheet for Line 17, do the following.

**Lines 2 through 7.** Skip these lines.

**Line 8.** Enter the amount from line 12 of the Qualified Dividends Tax Worksheet.

Complete all other lines as instructed on the worksheet.

### **Taxpayers Who Completed Schedule D**

If you have any qualified dividends, or lines 16 and 17a of your Schedule D (Form 1040) (lines 13 and 16a of your Schedule D (Form 1041)) are both gains, you must use the **Worksheet for Line 17** on page 15 to figure the amount of tax to enter on line 17 of Form 1116 if **either** of the following applies to you.

1. You figured your tax using Part IV of Schedule D (Form 1040), line 27 is equal to or greater than line 28, **and** line 51 is less than line 52. (For estates and trusts, if you completed Part V of Schedule D (Form 1041), line 24 is equal to or greater than line 25 **and** line 48 is less than line 49.)

2. You figured your tax using the Schedule D Tax Worksheet (in the Schedule D (Form 1040) instructions or in the Form 1041 instructions), line 17 is equal to or greater than line 15 **and** line 49 is less than line 50.

If you do not need to complete the Worksheet for Line 17, enter on line 17 of Form 1116 your taxable income without the deduction for your exemption (for example, the amount from Form 1040, line 38).

If you **do** need to complete the Worksheet for Line 17, do the following.

**Line 2.** Enter the amount (if any) from line 46 of the Schedule D Tax Worksheet.

**Line 4.** Enter the amount (if any) from line 43 of the Schedule D Tax Worksheet.

**Line 6.** Enter the amount (if any) from line 37 of the Schedule D Tax Worksheet **or** line 48 of Schedule D (Form 1040) (line 45 of Schedule D (Form 1041)).

**Line 8.** Enter the amount (if any) from line 35 of the Schedule D Tax

Worksheet or line 46 of Schedule D (Form 1040) (line 43 of Schedule D (Form 1041)).

Complete all other lines as instructed on the worksheet.

### **Line 19**

If you are completing line 19 for separate category **g** (lump-sum distributions), enter the amount from line 5 of the **Worksheet for Lump-Sum Distributions** on page 4.

Do not complete line 19 for separate category **h** (section 901(j) income). See page 4.

For all other applicable categories, complete line 19 as follows.

**Form 1040 filers:** Enter the amount from Form 1040, line 41, less any tax included on line 41 from Form 4972.

**Form 1040NR filers:** Enter the amount from Form 1040NR, line 39, less any tax included on line 39 from Form 4972.

**Form 1041 filers:** Enter the amount from Form 1041, Schedule G, line 1a.

### **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 of 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 of 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 or qualified dividends that are subject to the capital gain rate differential (figured in the **Worksheet for Line 17** on page 15).*

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### **Paperwork Reduction Act Notice.**

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

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**, 3 hr., 13 min.; **Learning about the law or the form**, 1 hr., 6 min.; **Preparing the form**, 2 hr., 51 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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