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James P. Fuller

Frederick R. Chilton Jr.

Ronald B. Schrotenboer

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The Foreign Tax Credit

By JAMES P. FULLER

B.S., New York University, 1966; J.D., Fordham University, 1970; LL.M., New York University, 1974; Partner, Fenwick, Stone, Davis & West, Palo Alto.

FREDERICK R. CHILTON, JR.*

B.A., Fresno State College, 1967; J.D., Hastings College of the Law, 1971; LL.M., New York University, 1973; Partner, Fenwick, Stone, Davis & West, Palo Alto.

RONALD B. SCHROTENBOER

B.A., Calvin College, 1977; J.D., University of Michigan, 1980; Associate, Fenwick, Stone, Davis & West, Palo Alto.

I. INTRODUCTION

A. Scope

This outline is a general review of the United States foreign tax credit. It includes the taxes that are creditable, the eligibility for and computation of the direct and indirect foreign tax credit, and the limitations on the amount of the foreign tax credits. It does not include special oil and gas, consolidated return, or treaty rules.

B. Concepts

1. Under United States tax law, United States residents and corporations are taxed on their worldwide income. Thus, income of U.S. residents and corporations is subject to United States income tax regardless of where it is earned. When income is earned outside the United States, it is usually also taxed in the country in which it originates. As a result, the problem of international

* This outline was prepared for Mr. Chilton's presentation and was provided to all attendees.

double taxation arises. The principal method of coping with international double taxation by the United States is by means of the foreign tax credit.

The U.S. foreign tax credit system embodies the principle that the country in which a business activity is conducted or in which income is earned has the first right to tax the income, even though the activities are conducted by U.S. corporations or residents. Under this concept, however, the United States retains a residual right to tax the income of its citizens and corporations.

2. As the name suggests, the foreign tax credit is a dollar-for-dollar credit against U.S. income tax liability for income taxes paid to foreign countries.

C. Background

Prior to World War I, the United States treated an income tax paid to a foreign country the same as any other expense. That is, it allowed a deduction for the foreign tax in computing taxable income subject to United States income tax. Because the tax rates in the United States and in other countries were relatively low, the total tax cost was not significant.

During World War I, however, the tax rates in the United States and abroad increased substantially. The increase in rates highlighted the problem of double taxation of foreign income. In addition, it focused attention on the fact that double taxation of foreign income resulted in a higher rate of taxation for U.S. corporations and residents on their foreign income. This conflicted with the premise that domestic and foreign income should bear, if possible, an equal tax burden.

In order to minimize these problems, Congress enacted the foreign tax credit in 1918. The effect of the foreign tax credit is that when the foreign tax rate is lower than the United States rate, a tax is paid to the United States at a rate equal to the excess of the United States rate over the foreign rate. When the foreign rate equals or exceeds the United States rate, the credit cancels United States tax liability. Thus, the credit generally operates to reduce the ef-

fective overall rate of tax on foreign income to the higher of the foreign or the United States rate.

D. Types of foreign tax credits

1. Direct credit. I.R.C. § 901.
2. Indirect credit. I.R.C. § 902.
3. Indirect credit for Subpart F income. I.R.C. § 960.
4. Credit for income of aliens and foreign corporations effectively connected with the conduct of a U.S. trade or business. I.R.C. § 906.

E. Creditable foreign taxes

A credit is available for "income, war profits and excess profits taxes" (I.R.C. § 901(b)) or taxes "in lieu" of such taxes imposed by a foreign country, a possession of the U.S. or a subdivision of either (I.R.C. § 903).

1. Taxes

a. Income taxes. Recently, the question of what constitutes an income tax has been the subject of considerable controversy. Because of recent Internal Revenue Service (IRS) revenue rulings and regulations, significant litigation with respect to this issue is anticipated. The IRS has taken the position that certain payments made to foreign governments are something other than taxes.

1) Royalties. In Rev. Rul. 76-215, 1976-1 C.B. 194, the IRS took the position that royalties were not taxes. Under section 4.901-2(b)(1)(i) of the temporary regulations, payment by a person is presumed to be compensation for a specific benefit if the foreign government provides that person with an economic benefit (including the right to extract minerals) not provided to others that do not pay the charge. The presumption, however, is rebuttable, and the regulations provide certain methods of rebutting the presumption. *See* Temp. Treas. Reg. § 4.901-2(b)(1)(ii).

2) Refundable payments. In Rev. Rul. 69-19, 1969-1 C.B. 197, and Rev. Rul. 60-56, 1960-1 C.B. 274, the IRS held that payments were mandatory loans and not taxes, so that they were not credit-

able. Rev. Rul. 59-70, 1959-1 C.B. 186-88, held that refundable payments were not creditable because the "refundable portion. . .[was] definitely ascertainable in amount at the time the tax accrued or was paid." Temp. Treas. Reg. § 4.901-2(f)(2) provides that an amount is not creditable if it will be refunded.

3) Equity investments. Rev. Rul. 63-49, 1963-1 C.B. 124.

4) Settlement of a dispute. Rev. Rul. 68-149, 1968-1 C.B. 341.

b. Revenue rulings and proposed regulations set forth certain requirements that must be met in order for the IRS to recognize taxes as income taxes.

1) Net income taxes on realized income. Temp. Treas. Regs. § 4.901-2(a)(1)-(2); Rev. Rul. 78-61, 1978-1 C.B. 221; Rev. Rul. 78-62, 1978-1 C.B. 226; Rev. Rul. 78-63, 1978-1 C.B. 228.

2) Withholding taxes. Rev. Rul. 78-234, 1978-1 C.B. 237; Temp. Treas. Reg. § 4.901(c)(4)(iii).

c. Other taxes. There is little authority on excess profits and war profits taxes.

d. Taxes in lieu of income taxes. Temp. Treas. Reg. § 4.903-1(a) enumerates certain requirements, some of which are:

1) The charge is a tax;

2) The charge is clearly intended and in fact operates as a charge imposed in substitution for and not in addition to an income tax otherwise generally imposed; and

3) The foreign law is structured so that the amount of the charge will generally not be significantly greater than the amount which would otherwise be payable on the income if the general income tax were applicable.

F. Non-creditable foreign taxes

All other foreign taxes can be deducted under I.R.C. § 164

unless otherwise required to be capitalized; *e.g.*, capital stock issuance taxes.

G. Liability for foreign income tax

1. An issue that may arise is whether the taxpayer claiming a credit is liable for the foreign income tax. Rev. Rul. 77-267, 1977-2 C.B. 243; Rev. Rul. 70-290, 1970-1 C.B. 160. The IRS takes the position that for a payment to be a tax, it must be compulsory, *i.e.*, made pursuant to a legal liability. Temp. Treas. Reg. § 4.901-2(f)(5). A payment is not compulsory to the extent that it exceeds legal liability. *Id.* A payment may exceed legal liability, for example, if all effective and practical remedies are not exhausted in seeking a reduction of liability. *Id.; contra Schering Corp. v. Commissioner*, 69 T.C. 579 (1978); *Gulf-Puerto Rico Lines, Inc. v. Commissioner*, 61 T.C. 644 (1970).
2. A credit may be accrued for a contested tax prior to settlement of the dispute. Temp. Treas. Reg. § 4.901-2(f)(6). Thus, the temporary regulations liberalize the rule with respect to accrual of contested taxes. *See* Rev. Rul. 58-55, 1958-1 C.B. 266.

H. Credit not allowed against certain taxes
See I.R.C. § 901(a).

1. Minimum tax for tax preferences. I.R.C. § 56.
2. Tax on premature distributions to owner employees. I.R.C. § 72(m)(5)(B).
3. Tax on lump sum retirement plan distributions. I.R.C. § 402(e).
4. Tax on income from certain retirement accounts. I.R.C. § 408(f).
5. Accumulated earnings tax. I.R.C. § 531.
6. Personal holding company tax. I.R.C. § 541.
7. Additional tax on recoveries of foreign expropriation losses. I.R.C. § 1351.

I. Election of credit or deduction

1. Except for indirect credits, a taxpayer may elect annually to credit or deduct foreign taxes eligible for credit. I.R.C. §§ 904(a) and 164(a)(3). The election relates to all creditable taxes. Treas. Reg. § 1.901-1(c). A

deduction is a reduction in taxable income, worth only an amount equal to the effective tax rate on such income.

2. Election may be made or changed for any taxable year at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by the Internal Revenue Code for such taxable year. The regulations provide that this is the later of three years from the due date of the return, or two years from payment of the tax. Treas. Reg. § 1.901-1(d). However, the Court of Claims has held that this means ten years from the date prescribed for filing the return pursuant to I.R.C. § 6511(d)(3). *Hart v. United States*, 78-2 U.S.T.C. ¶ 9751 (Ct. Cl. 1978).
3. Deduction may not be taken if the taxpayer elects to credit taxes. I.R.C. § 275(a)(4).

II. DIRECT CREDIT

A. Eligibility

1. Citizens and domestic corporations. I.R.C. § 901(b)(1).
   a. Individual can elect to take standard deduction and obtain foreign tax credit. *Compare* I.R.C. § 36 *with* I.R.C. § 36 prior to the Tax Reform Act of 1976.
   b. A regulated investment company which has elected pursuant to I.R.C. § 853 to currently distribute its income to its shareholders is ineligible for direct credit. Treas. Reg. § 1.901-1(h)(3).
2. Resident of the U.S. or Puerto Rico. I.R.C. § 901(b)(2).
   a. Credit available for income taxes imposed by any foreign country (I.R.C. § 901(b)(2)), or possession of the U.S. (I.R.C. § 901(b)(3)).
   b. Resident aliens. I.R.C. § 901(b)(3). The President can suspend entitlement to credit for taxes paid to foreign countries if the country of which the alien is a national does not extend a reciprocal credit to U.S. citizens. I.R.C. § 901(c).
3. Foreign corporation or nonresident alien individual engaged in business in the U.S. may claim a credit for taxes imposed by foreign country or possession on in-

come effectively connected with U.S. business, unless foreign tax is imposed solely because of citizenship, residence, or domicile in the foreign country. I.R.C. § 906(a)-(b).

4. Partnerships, estates, and trusts. I.R.C. § 901(b)(5).
   a. An individual who is a member of a partnership may claim as a credit his proportionate share of creditable taxes paid or accrued by the partnership. *Id.*
   b. Partners are independently allowed the credit for taxes imposed on the partnership, I.R.C. § 702(a)(6); thus, each partner can elect to credit or deduct taxes, I.R.C. § 703(b).
   c. An estate or trust may claim the credit only in respect of such amount of the creditable tax as is not properly allocable to the beneficiary, I.R.C. § 642(a)(1); beneficiary may claim proportionate share of creditable taxes paid or accrued by estate or trust.

B. Nature of credit

1. Applies to creditable foreign taxes imposed on the taxpayer.
2. One issue that occasionally arises is whether a particular tax is imposed on the U.S. taxpayer and is therefore eligible for the direct credit or is imposed on a foreign entity and is therefore eligible only as an indirect credit under I.R.C. § 902. *Abbot Laboratories Int'l Co. v. United States*, 160 F. Supp. 321 (N.D. Ill. 1958), *aff'd*, 267 F.2d 940 (7th Cir. 1959); Rev. Rul. 77-209, 1977-1 C.B. 238; Rev. Rul. 58-518, 1958-2 C.B. 381.
3. Direct credit is computed on a grossed-up basis; *e.g.*, a foreign corporation pays a dividend of $1,000 to a U.S. individual subject to a 30% withholding tax. The U.S. taxpayer would report $1,000 dividend income and claim a credit of $300.

C. Accounting rules

1. Cash basis taxpayer. Creditable in year when paid; at the option of the taxpayer, the credit may be taken in the year when the taxes accrued. I.R.C. § 905(a). How-

ever, if election is made, credits for all subsequent years must be taken on the same basis, and no such taxes will be allowed as a deduction in the same or any succeeding year. *Id.*

2. Accrual basis. Creditable in the year accrued.
3. Blocked income. Credit taken in year in which income is includable for U.S. tax purposes. Treas. Reg. § 1.905-1(b).
4. All computations are made in U.S. dollars.
   a. A cash basis taxpayer uses the exchange rates applicable on the date of payment. Rev. Rul. 73-491, 1973-2 C.B. 268.
   b. An accrual basis taxpayer uses exchange rate at year-end subject to adjustment based on the exchange rate when the tax is actually paid. Rev. Rul. 73-491, 1973-2 C.B. 267; Rev. Rul. 73-506, 1973-2 C.B. 268; *Comprehensive Designers International Inc. v. Commissioner*, 66 T.C. 348 (1976); *see also First National City Bank v. United States*, 557 F.2d 1379 (Ct. Cl. 1977); *American Telephone & Telegraph Co. v. United States*, 440 F. Supp. 172 (S.D.N.Y. 1978), *aff'd*, 567 F.2d 554 (2d Cir. 1978).

III. INDIRECT CREDIT

A. Deemed paid credit: I.R.C. § 902

1. Domestic corporation. I.R.C. § 902(a); I.R.C. § 7701(a)(3)-(4).
2. Ownership of at least 10% of the voting stock of a foreign subsidiary. I.R.C. § 902(a)(1).
3. Foreign taxes paid by second and third tier foreign subsidiaries qualify if
   a. each subsidiary is at least 10% owned by its immediate parent, (I.R.C. § 902(b)(1)-(2)), and
   b. the U.S. parent's indirect ownership in such a lower-tier subsidiary is at least 5%. I.R.C. § 902(b)(3).

B. Calculation for first-tier subsidiary

Assume P, a U.S. corporation, owns 100% of S, a foreign corporation. S has $100 of net profits for the year, pays $40 foreign income taxes and remits a $30 dividend to P.

1) $$\text{credit} = \frac{\text{dividend}}{\text{accumulated profits}} \times \text{foreign income tax}$$

2) $$\frac{30}{60} \times 40 = \$20$$

3) P has received $30 of dividend income which it must gross-up under I.R.C. § 78 by $20 so that it reports $50 of dividend income. P is entitled to claim a $20 foreign tax credit.

4) P owes U.S. tax (at 46%) of $3 ($23 less a credit of $20).

C. Calculation for lower-tier subsidiaries

Assume P, a U.S. corporation, owns 100% of S-1, a foreign corporation and that S-1 owns 100% of S-2, a second foreign corporation. S-1 and S-2 each earn $100 and pay foreign tax of $40. S-2 distributes a dividend of $30 to S-1 and S-1 distributes a dividend of $60 to P. *See* Treas. Reg. § 1.902-1(k), Ex. 3.

1) $$\text{S-2: } \frac{30}{60} \times 40 = \$20$$

2) $$\text{S-1: } \frac{60}{90} \times 60\ [40 + 20] = \$40$$

3) P has $60 of dividend income, $40 of I.R.C. § 78 gross-up income and a foreign tax credit of $40.

4) P owes U.S. tax (at 46%) of $6 ($46–40).

D. Special rules

1. Dividends are deemed paid from earnings and profits of payor on a last-in-first-out (LIFO) basis—dividends are first paid from current year's earnings, then from prior year's earnings starting with the most recent year first. I.R.C. § 902(c). *See H.H. Robertson Co. v. Commissioner*, 59 T.C. 53 (1972), *aff'd*, 3d Cir. July 24, 1974 (unpublished opinion); *General Foods Corp. v. Commissioner*, 4 T.C. 209 (1944), *acq.*, 1946-1 C.B. 2.
2. Dividends paid during the first sixty days of any year are usually treated as having been paid out of the prior year's earnings. I.R.C. § 902(c).
3. The deemed paid credit must be calculated separately

for each first tier corporation that remits a dividend to the U.S. parent.

E. Definitional aspects

1. Dividend—defined in I.R.C. § 316.

   a. Distributions of property are taxed at the property's fair market value. I.R.C. § 301(b)(1)(c).

   b. Distributions taxed at capital gains rates do not carry "deemed paid" foreign tax credits. *Fowler Hosiery Co., Inc. v. Commissioner*, 301 F.2d 394 (7th Cir. 1962); *Associated Telephone & Telegraph Co. v. United States*, 306 F.2d 824 (2d Cir. 1962); *Freeport Sulphur Co. v. United States*, 163 F. Supp. 648 (Ct. Cl. 1958).

   c. If local tax is withheld from the dividend, the net cash received must be grossed-up by the amount of the tax withheld to arrive at the amount of the dividend. For example, assume a $100 dividend is declared, $15 is withheld, and $85 cash is received. The dividend is $100. The $15 tax withheld is a direct I.R.C. § 901 credit.

2. Accumulated profits

   a. Generally, accumulated profits represent annualized earnings and profits of the foreign corporation computed in accordance with U.S. tax accounting concepts. *See H.H. Robertson Co. v. Commissioner*, 59 T.C. 53 (1972), *aff'd* 3d Cir. July 24, 1974 (unpublished opinion); *Steel Improvement and Forge Co. v. Commissioner*, 36 T.C. 265 (1961), *rev'd on other grounds*, 312 F.2d 96 (6th Cir. 1963); Rev. Rul. 63-6, 1963-1 C.B. 126, superseded by Rev. Rul. 72-621, 1972-2 C.B. 651.

   b. Although the amount of the dividend and foreign tax paid are normally fixed (subject, of course, to the decision on how much to remit), there is room for tax planning with regard to the amount of accumulated profits. The smaller the accumulated profits figure, the higher the effective foreign tax rate for credit purposes.

   c. Earnings and profits can be a difficult concept.

Special Subpart F rules are set forth in Treas. Reg. § 1.964-1.

1) Treas. Reg. § 1.902-1(g) permits a one-time election to use the rules and procedures of Treas. Reg. § 1.964-1 (exclusive of Treas. Reg. § 1.964-1(d) and (e) regarding translation and exchange gain or loss) for purposes of I.R.C. § 902.

2) The rules set forth in Treas. Reg. §§ 1.964-1(a)-(c) offer much in the way of tax planning potential; *e.g.*, various tax accounting elections can be made to reduce a foreign subsidiary's earnings and profits.

3. Foreign tax
   a. "On or with respect to such accumulated profits."
   b. The foreign tax must qualify as an "income tax," as is required for direct credits.
   c. The U.S. parent corporation need not own the subsidiary when the foreign taxes are paid. *See* Treas. Reg. § 1.902-1(d).
   d. A credit can be claimed for taxes that are properly accrued even though payment is deferred. Rev. Rul. 70-303, 1970-1 C.B. 161.

F. Foreign tax rates "average" when dividends are paid up through tiers of foreign subsidiaries

1. S-1 earns $100 and pays a tax of $60 (60%). S-2 earns $100 pays a tax of $10 (10%). S-2 pays a $60 dividend to S-1, and S-1, in turn, remits a $60 dividend to P (assume 100% ownership).
   a. $$\text{S-2: } \$6.67 = \frac{60}{90} \times 10$$
   b. $$\text{S-1: } \$40 = \frac{60}{100} \times 66.67\ (60 + 6.67)$$
   c. P has $60 of dividend income, $40 of I.R.C. § 78 gross-up income and a foreign tax credit of $40 (40% effective rate).
2. Compare: if S-2 were instead a first-tier subsidiary that had paid the dividend directly to P, P would have a $60 dividend, $6.67 of I.R.C. § 78 gross-up income and a $6.67 foreign tax credit, with an effective rate of 10%.

3. If S-1 and S-2 were reversed, it would be advantageous to have the lower tier subsidiary (60% effective rate) pay a dividend to the first tier subsidiary (10% effective rate) to "average up" the effective foreign tax rate before a dividend is paid to P.

G. Problem areas

1. Mismatches in computation of earnings and income under U.S. and foreign systems. For foreign losses, see Rev. Rul. 74-550, 1974-2 C.B. 209.
2. I.R.C. § 482 adjustments. Rev. Rul. 76-508, 1976-1 C.B. 225; *see also* Rev. Ruls. 74-158, 1974-1 C.B. 182; 72-370, 1972-2 C.B. 437; 72-371, 1972-2 C.B. 438; and 80-231, 1980-2 C.B. 219. *See* discussion of liability, *supra*.

H. "Deemed paid" credit: I.R.C. § 960 (Subpart F)

1. Ownership rules (10%-10%-10%, 5% overall) same as I.R.C. § 902 effective January 1, 1977.
2. Subpart F income
   a. "hopscotches" to the U.S. shareholder without an "averaging" of foreign tax rates, and
   b. can "flow up" from fourth and lower tier foreign subsidiaries without a foreign tax credit because I.R.C. § 960 is limited to three foreign tiers.
3. Distributions of previously taxed income (I.R.C. § 959) do not carry "deemed paid" foreign tax credits (which, of course, have already been claimed), except that additional foreign tax due as a result of the distribution will qualify for a foreign tax credit. *See* I.R.C. § 960(a)(2)-(3); *see also* I.R.C. § 960(b).

IV. CREDIT FOR NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

A. Applicability

1. Nonresident alien individuals and foreign corporations can credit income taxes imposed on income which is effectively connected with the conduct of a trade or business within the U.S. under I.R.C. § 906(a).
2. The amount of credit determined under I.R.C. § 901 or I.R.C. § 902.

B. Special rules

1. Creditable taxes imposed on U.S. source income are not taken into account if such income would not have been taxed if the taxpayers were not:
   a. in the case of an individual, a citizen or resident of that country (I.R.C. § 906(b)(1)(A)); or
   b. if a corporation, incorporated under the law of (or domiciled for tax purposes in) that country. I.R.C. § 906(b)(1)(B).
2. A credit is not available against taxes on income not effectively connected with taxpayer's U.S. trade or business. I.R.C. § 906(b)(3).

V. LIMITATIONS ON THE AMOUNT OF FOREIGN TAX CREDIT ALLOWABLE

During World War I, the United States tax rate was raised to finance the war. Because the U.S. rate was relatively high when the foreign tax credit was enacted, most U.S. taxpayers did not pay foreign taxes at rates in excess of the U.S. tax. Following World War I, however, the United States reverted to a lower rate of tax. After the war, the United Kingdom tax rate of 26% was more than double the U.S. rate of 12%. As a consequence, U.S. taxpayers were able to offset U.S. tax on U.S. income, with credits for United Kingdom tax.

The foreign tax credit limitation was enacted to prevent this. Under the limitation the credit for creditable taxes may not exceed the effective U.S. tax rate on the U.S. taxpayer's foreign source income. The formula is as follows:

$$\frac{\text{foreign source taxable income}}{\text{worldwide taxable income}} \times \text{tentative U.S. tax}$$

Note that the limitation applies to I.R.C. §§ 901, 902, and 960 credits as an aggregate.

A. Methods

Since 1976, the overall method of the foreign tax credit limitation must be used by all taxpayers. It is calculated on the basis of worldwide income.

B. Separate limitations

1. Interest income other than:
   a. on transactions directly related to business abroad;
   b. derived in banking or financing business;
   c. received from subsidiary in which taxpayer owns at least 10% of the voting stock; and
   d. on obligations arising on disposition of foreign business or 10% stock interest. I.R.C. § 904(d)(2).
2. Certain DISC dividends. I.R.C. § 904(d)(1).

C. Special rules
1. Foreign losses: I.R.C. § 904(f)
   a. "Overall foreign loss" is subject to recapture, which means only that subsequent foreign source income is treated as U.S. source income (thereby possibly limiting foreign tax credits under I.R.C. § 904) to the extent of the lesser of
      1) the recapturable loss, or
      2) fifty percent of foreign source income (or such larger percent as the taxpayer may choose). I.R.C. § 904(f)(1).
   b. The "disposition rule" can result in income creation. I.R.C. § 904(f)(3). The disposition of property which has been used predominantly outside the U.S. in a trade or business generates U.S. source *taxable* gain, even if otherwise disposed of in a tax-free transaction, to the extent of unrecaptured recapturable losses.
2. Capital gain rules: I.R.C. § 904(b)
   a. Foreign source income includes gain from the sale or exchange of capital assets only in an amount equal to the lesser of
      1) capital gain net income (LT and ST) from sources without the U.S., or
      2) capital gain net income (LT and ST). I.R.C. § 904(b)(3).
   b. Corporations are subject to an additional rule: capital gain net income is reduced by the rate differential portion of net capital gain (LTCG over STCL) in both the numerator and the denominator

of the I.R.C. § 904 fraction. I.R.C. § 904(b)(2). The rate differential portion of net capital gain is the name proportion of such amount as the excess of the highest rate of tax specified in section 11(b) over the alternative rate of tax under section 1201(a) bears to the highest rate of tax specified in section 11(b). I.R.C. § 904(b)(1)(F).

c. The new "10% rule" is very important
    1) if personal property is sold outside the U.S. (to generate foreign source gain), any gain will be treated as U.S. source gain
    2) unless the gain is subject to a 10% or more local income tax
    3) if the requisite contacts between the property and the country of sale are absent.

D. Determination of taxable income for limiting fraction
  1. Computation of foreign and worldwide taxable income requires a two-fold determination:
    a. determination of the geographical source of income under I.R.C. §§ 861-863, taking into account special rules of I.R.C. § 904(b) & (f); and
    b. allocation and apportionment of losses, expenses, or other deductions ("deductions") against income. Treas. Reg. § 1.861-8.
  2. The statutory pattern is to follow I.R.C. §§ 861(b), 862(b), 863(a).
    a. The Code provides two general rules which require a priority of application for allocation and apportionment of deductions in order to determine foreign or U.S. source taxable income, as the case may be.
        1) Deductions directly related to an item or class of gross income are deducted from such items or class.
        2) Remaining deductions which cannot be definitely allocated to some item or class of gross income are ratably apportioned among all items or classes of gross income.
    b. Special rules. I.R.C. § 863(b).
  3. Regulatory regimens

Taxable years beginning after (or at the election of the taxpayer, before) December 31, 1976. Treas. Reg. § 1.861-8, as promulgated on January 3, 1977 (T.D. 5456) applies. *See* Treas. Reg. § 1.861-8(a)(5).

4. The section 861 regulations. Very complex: a subject unto themselves.

E. Carrybacks and carryovers of excess credits

1. Carry back—2 years. I.R.C. § 904(c).
2. Carry forward—5 years. I.R.C. § 904(c).
3. Current year's credits always used first.

VI. PROOF OF CREDITS AND FORMS

A. Proof. I.R.C. § 905(b).

B. Noncompliance. I.R.C. § 6083.

C. Forms:

1. Individual. Form 1116.
2. Corporation. Form 1118.

VII. SUBSEQUENT ADJUSTMENTS

A. I.R.C. § 905(c). Note there is no statute of limitations regarding the notice requirements. *See also* I.R.C. § 6689 (new).

B. I.R.C. § 6511(d)(3). Special 10-year statute of limitations for refunds.