

States in a trade or business. Such property generated income subject to the general limitation. The excess of the property's fair market value over its adjusted basis is \$3,000. The disposition is of a type described in § 1.904(f)-2(d)(4)(i). W has no other income in 1986. Under § 1.904(f)-2(d)(4)(i), W is required to recognize foreign source taxable income on the disposition in an amount equal to the lesser of \$2,000 (\$800 (the balance in the general limitation overall foreign loss account as of 1985) + \$400 (the increase in the general limitation overall foreign loss account attributable to the disposition year) + \$600 (the general limitation overall foreign loss that is part of the NOL from 1986) + \$200 (the general limitation overall foreign loss that is part of the NOL from 1985)) or \$3,000. The \$2,000 foreign source income required to be recognized under section 904(f)(3) is reduced to \$1,200 by the remaining \$600 loss in 1986 and the \$200 net operating loss carried forward from 1985. This \$1,200 of income is subject to the general limitation. In computing foreign tax credit limitation for general limitation income, the \$1,200 of foreign source income is treated as United States source income and, therefore, W's foreign tax credit limitation for income subject to the general limitation is zero. W's overall foreign loss account is reduced to zero.

Example 4. Z Corporation has a balance in its FORI overall foreign loss account of \$1,500 at the end of its taxable year 1980. In 1981, Z has \$1,600 of foreign oil related income subject to the separate limitation for FORI income and no United States source income. In addition, in 1981, Z makes two dispositions of property used predominantly outside the United States in a trade or business on which no gain was recognized. Such property generated foreign oil related income. The excess of the fair market value of the property transferred in the first disposition over Z's adjusted basis in such property is \$575. The excess of the fair market value of the property transferred in the second disposition over Z's adjusted basis in such property is \$1,000. Under paragraph (c) of this section, Z is required to recapture \$800 (the lesser of 50 percent of its foreign oil related income of \$1,600 or the balance (\$1,500) in its FORI overall foreign loss account) of its foreign oil related loss. In accordance with paragraphs (d)(4) (i) and (iv) of this section, Z is required to recognize foreign oil related income in the amount of \$575 on the first disposition and, since the foreign oil related loss account is now reduced by \$1,375 (the \$800 and \$575 amounts previously recaptured), Z is required to recognize foreign oil related income in the amount of \$125 on the second disposition. In accordance with paragraph (d)(4)(iii) of this section, the entire amount recognized is treated as United States source income and the balance in the FORI overall foreign loss account is reduced

to zero under § 1.904(f)-1(e)(2). Z's foreign tax credit limitation for FORI is \$400 (\$800/\$2,300×\$1,150) instead of \$800 (\$1,600/\$1,600×\$800).

Example 5. The facts are the same as in example 4, except that the gain from the two dispositions of property is treated as net capital gain and the United States corporate tax rate is assumed to be 46 percent. As in example 4, Z is required to recapture \$800 of its foreign oil related loss from its 1981 ordinary foreign oil related income. In accordance with paragraph (d)(4) (i) and (iv) of this section, Z is first required to recognize foreign oil related income (which is net capital gain) on the first disposition in the amount of \$575. Under paragraphs (b) and (d) (2) of this section, this net capital gain is adjusted by subtracting the rate differential portion of such gain from the total amount of such gain to determine the amount by which the foreign oil related loss account is reduced, which is \$350 (\$575 - (\$575×18/46)). The balance remaining in Z's foreign oil related loss account after this step is \$350. Therefore, this process will be repeated, in accordance with paragraph (d)(4)(iv) of this section, to recapture that remaining balance out of the gain deemed recognized on the second disposition, resulting in reduction of the foreign oil related loss account to zero and net capital gain required to be recognized from the second disposition in the amount of \$575, which must also be adjusted by subtracting the rate differential portion to determine the amount by which the foreign oil related loss account is reduced (which is \$350). The \$575 of net capital gain from each disposition is recharacterized as United States source net capital gain. Z's section 907 (b) foreign tax credit limitation is the same as in example 4, and Z has \$1,150 (\$575+\$575) of United States source net capital gain.

(e) [Reserved] For further guidance, see § 1.904(f)-2T(e).

[T.D. 8153, 52 FR 31997, Aug. 25, 1987; 52 FR 43434, Nov. 12, 1987, as amended by T.D. 9371, 72 FR 72597, Dec. 21, 2007]

§ 1.904(f)-2T Recapture of overall foreign losses (temporary).

(a) and (b) [Reserved] For further guidance, see § 1.904(f)-2(a) and (b).

(c) *Section 904(f)(1) recapture—(1) In general.* In a year in which a taxpayer elects the benefits of section 901 or 30A, the amount of foreign source taxable income subject to recharacterization in a taxable year in which paragraph (a) of this section is applicable is the lesser of the aggregate amount of maximum potential recapture in all overall foreign loss accounts or fifty percent of

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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