

Internal Revenue Service, Treasury

§ 1.904(i)-1

overall domestic loss account with respect to the general category.

Example 6. (i) *Facts.* (A) Y Corporation is a domestic corporation with foreign branch operations in Country D. Y has no net operating losses and does not make an election to recapture more than the required amount of overall foreign losses. As of January 1, 2007, Y has a (\$200) general category overall foreign loss (OFL) account and a (\$200) general category separate limitation loss (SLL) account with respect to the passive category. For 2007, Y has \$400 of passive category income that is fully offset by a (\$400) domestic loss in that taxable year, giving rise to the creation of an overall domestic loss (ODL) account with respect to the passive category. As of January 1, 2008, Y has the following balances in its OFL, SLL, and ODL accounts:

General		US Passive ODL
OFL	Passive SLL	
\$200	\$200	\$400

(B) In 2008, Y has the following taxable income and losses:

General	Passive	US
\$400	(\$100)	\$600

(i) *Loss allocation.* Under Step 2, the \$100 of passive category loss offsets \$100 of the general category income, creating a passive category SLL account of \$100 with respect to the general category. Because there is an offsetting general category SLL account of \$200 with respect to the passive category from a prior taxable year, the two accounts are netted against each other so that all that remains is a \$100 general category SLL account with respect to the passive category.

(iii) *OFL account recapture.* Under Step 4, 50 percent of the remaining \$300, or \$150, of income in the general category is subject to recharacterization as U.S. source income as a recapture of part of the OFL account in the general category.

(iv) *SLL account recapture.* Under Step 5, \$100 of the remaining \$150 of income in the general category is recharacterized as passive category income as a recapture of the general category SLL account with respect to the passive category.

(v) *ODL account recapture.* Under Step 6, 50 percent of the \$600, or \$300, of U.S. source income is subject to recharacterization as foreign source passive category income as a recapture of a part of the ODL account with respect to the passive category. None of the \$150 of general category income that was recharacterized as U.S. source income under Step 5 is included here as income subject to recharacterization in connection with recapture of the overall domestic loss account.

(v) *Results.* (A) After the allocation of loss and recapture of loss accounts, X has the following taxable income and losses for 2008:

General	Passive	US
\$50	\$400	\$450

(B) As of January 1, 2009, Y has the following balances in its OFL, SLL and ODL accounts:

General		Passive	US
OFL	Passive SLL	General SLL	Passive ODL
\$50	\$0	\$0	\$100

(i) *Effective/applicability date.* This section applies to taxable years beginning after *December 21, 2007*. Taxpayers may choose to apply this section to other taxable years beginning after *December 31, 2006*, as well.

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

[T.D. 9371, 72 FR 72599, Dec. 21, 2007]

§ 1.904(i)-0 Outline of regulation provisions.

This section lists the headings for § 1.904(i)-1.

§ 1.904(i)-1 Limitation on use of deconsolidation to avoid foreign tax credit limitations.

- (a) General rule.
 - (1) Determination of taxable income.
 - (2) Allocation.
- (b) Definitions and special rules.
 - (1) Affiliate.
 - (i) Generally.
 - (ii) Rules for consolidated groups.
 - (iii) Exception for newly acquired affiliates.
 - (2) Includible corporation.
- (c) Taxable years.
- (d) Consistent treatment of foreign taxes paid.
- (e) Effective date.

[T.D. 9371, 72 FR 72603, Dec. 21, 2007]

§ 1.904(i)-1 Limitation on use of deconsolidation to avoid foreign tax credit limitations.

(a) *General rule.* If two or more includible corporations are affiliates, within the meaning of paragraph (b)(1) of this section, at any time during their taxable years, then, solely for purposes of applying the foreign tax

credit provisions of section 59(a), sections 901 through 908, and section 960, the rules of this section will apply.

(1) *Determination of taxable income*—(i) Each affiliate must compute its net taxable income or loss in each separate category (as defined in § 1.904-5(a)(1), and treating U.S. source income or loss as a separate category) without regard to sections 904(f) and 907(c)(4). Only affiliates that are members of the same consolidated group use the consolidated return regulations (other than those under sections 904(f) and 907(c)(4)) in computing such net taxable income or loss. To the extent otherwise applicable, other provisions of the Code and regulations must be used in the determination of an affiliate's net taxable income or loss in a separate category.

(ii) The net taxable income amounts in each separate category determined under paragraph (a)(1)(i) of this section are combined for all affiliates to determine one amount for the group of affiliates in each separate category. However, a net loss of an affiliate (first affiliate) in a separate category determined under paragraph (a)(1)(i) of this section will be combined under this paragraph (a) with net income or loss amounts of other affiliates in the same category only if, and to the extent that, the net loss offsets taxable income, whether U.S. or foreign source, of the first affiliate. The consolidated return regulations that apply the principles of sections 904(f) and 907(c)(4) to consolidated groups will then be applied to the combined amounts in each separate category as if all affiliates were members of a single consolidated group.

(2) *Allocation*. Any net taxable income in a separate category calculated under paragraph (a)(1)(ii) of this section for purposes of the foreign tax credit provisions must then be allocated among the affiliates under any consistently applied reasonable method, taking into account all of the facts and circumstances. A method is consistently applied if used by all affiliates from year to year. Once chosen, an allocation method may be changed only with the consent of the Commissioner. This allocation will only affect the source and foreign tax credit separate limitation character of the income for pur-

poses of the foreign tax credit separate limitation of each affiliate, and will not otherwise affect an affiliate's total net income or loss. This section applies whether the federal income tax consequences of its application favor, or are adverse to, the taxpayer.

(b) *Definitions and special rules*— For purposes of this section only, the following terms will have the meanings specified.

(1) *Affiliate*—(i) *Generally*. Affiliates are includible corporations—

(A) That are members of the same affiliated group, as defined in section 1504(a); or

(B) That would be members of the same affiliated group, as defined in section 1504(a) if—

(1) Any non-includible corporation meeting the ownership test of section 1504(a)(2) with respect to any such includible corporation was itself an includible corporation; or

(2) The constructive ownership rules of section 1563(e) were applied for purposes of section 1504(a).

(ii) *Rules for consolidated groups*. Affiliates that are members of the same consolidated group are treated as a single affiliate for purposes of this section. The provisions of paragraph (a) of this section shall not apply if the only affiliates under this definition are already members of the same consolidated group without operation of this section.

(iii) *Exception for newly acquired affiliates*—(A) With respect to acquisitions after December 7, 1995, an includible corporation acquired from unrelated third parties (First Corporation) will not be considered an affiliate of another includible corporation (Second Corporation) during the taxable year of the First Corporation beginning before the date on which the First Corporation originally becomes an affiliate with respect to the Second Corporation.

(B) With respect to acquisitions on or before December 7, 1995, an includible corporation acquired from unrelated third parties will not be considered an affiliate of another includible corporation during its taxable year beginning before the date on which the first includible corporation first becomes an

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affiliate with respect to that other includible corporation.

(C) This exception does not apply where the acquisition of an includible corporation is used to avoid the application of this section.

(2) *Includible corporation.* The term *includible corporation* has the same meaning it has in section 1504(b).

(c) *Taxable years.* If all of the affiliates use the same U.S. taxable year, then that taxable year must be used for purposes of applying this section. If, however, the affiliates use more than one U.S. taxable year, then an appropriate taxable year must be used for applying this section. The determination whether a taxable year is appropriate must take into account all of the relevant facts and circumstances, including the U.S. taxable years used by the affiliates for general U.S. income tax purposes. The taxable year chosen by the affiliates for purposes of applying this section must be used consistently from year to year. The taxable year may be changed only with the prior consent of the Commissioner. Those affiliates that do not use the year determined under this paragraph (c) as their U.S. taxable year for general U.S. income tax purposes must, for purposes of this section, use their U.S. taxable year or years ending within the taxable year determined under this paragraph (c). If, however, the stock of an affiliate is disposed of so that it ceases to be an affiliate, then the taxable year of that affiliate will be considered to end on the disposition date for purposes of this section.

(d) *Consistent treatment of foreign taxes paid.* All affiliates must consistently either elect under section 901(a) to claim a credit for foreign income taxes paid or accrued, or deemed paid or accrued, or deduct foreign taxes paid or accrued under section 164. See also § 1.1502-4(a); § 1.905-1(a).

(e) *Effective date.* Except as provided in paragraph (b)(1)(iii) of this section (relating to newly acquired affiliates), this section is effective for taxable years of affiliates beginning after December 31, 1993.

[T.D. 8627, 60 FR 56119, Nov. 7, 1995]

§ 1.904(j)-0 Outline of regulation provisions.

This section lists the headings for § 1.904(j)-1.

§ 1.904(j)-1 Certain individuals exempt from foreign tax credit limitation.

(a) Election available only if all foreign taxes are creditable foreign taxes.

(b) Coordination with carryover rules.

(1) No carryovers to or from election year.

(2) Carryovers to and from other years determined without regard to election years.

(3) Determination of amount of creditable foreign taxes.

(c) Examples.

(d) Effective date.

[T.D. 9371, 72 FR 72603, Dec. 21, 2007]

§ 1.904(j)-1 Certain individuals exempt from foreign tax credit limitation.

(a) *Election available only if all foreign taxes are creditable foreign taxes.* A taxpayer may elect to apply section 904(j) for a taxable year only if all of the taxes for which a credit is allowable to the taxpayer under section 901 for the taxable year (without regard to carryovers) are creditable foreign taxes (as defined in section 904(j)(3)(B)).

(b) *Coordination with carryover rules—*

(1) *No carryovers to or from election year.* If the taxpayer elects to apply section 904(j) for any taxable year, then no taxes paid or accrued by the taxpayer during such taxable year may be deemed paid or accrued under section 904(c) in any other taxable year, and no taxes paid or accrued in any other taxable year may be deemed paid or accrued under section 904(c) in such taxable year.

(2) *Carryovers to and from other years determined without regard to election years.* The amount of the foreign taxes paid or accrued, and the amount of the foreign source taxable income, in any year for which the taxpayer elects to apply section 904(j) shall not be taken into account in determining the amount of any carryover to or from any other taxable year. However, an election to apply section 904(j) to any year does not extend the number of taxable years to which unused foreign taxes may be carried under section 904(c) and § 1.904-2(b). Therefore, in determining the number of such carryover years, the taxpayer must take