

Instructions for Form 1118

(Revised January 1999)

Foreign Tax Credit—Corporations

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



Department of the Treasury
Internal Revenue Service

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 Code section 6103.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

| Form | Recordkeeping | Learning about the law or the form | Preparing and sending the form to the IRS |
|--------------------|-----------------|------------------------------------|---|
| 1118 | 71 hr., 45 min. | 18 hr., 19 min. | 22 hr., 42 min. |
| Sch. I (Form 1118) | 8 hr., 51 min. | 1 hr. | 1 hr., 11 min. |
| Sch. J (Form 1118) | 89 hr., 12 min. | 1 hr., 5 min. | 2 hr., 35 min. |

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Changes To Note

The Taxpayer Relief Act of 1997 ("The Act") made changes to the tax law regarding the foreign tax credit. The major changes are discussed below.

- For tax years beginning after August 5, 1997, the deemed paid credit has been extended to foreign taxes paid or accrued by certain fourth-, fifth-, and sixth-tier corporations. See section 902(b). Schedules C, D, and E have been expanded to reflect the additional reporting requirement.
- For taxpayers claiming credits on the accrual basis in tax years beginning after December 31, 1997, the exchange rate for translating foreign taxes into U.S. dollars will generally be an average exchange rate for the tax year, rather than the spot rate on the payment date. A redetermination will be required if the taxes are not paid within 2 years after the close of the tax year to which such taxes relate. See sections 905 and 986(a).
- For transactions occurring after August 5, 1997, gains on dispositions of stock in lower-tier controlled foreign corporations (CFCs) may be treated as dividends received by the selling CFC to the same extent that the gain would be treated as a dividend under section 1248(a) if the CFC were a U.S. person. See section 964(e)(1).
- The Act disallows foreign tax credits for withholding taxes with respect to dividends paid or accrued on or after September 5, 1997, if a minimum holding period is not satisfied with respect to the

stock. The minimum holding period for common stock is 16 days. The minimum holding period for preferred stock is 46 days. See section 901(k).

- For a claim relating to an overpayment of U.S. tax attributable to foreign tax credits, the limitation period is determined by reference to the year with respect to which the foreign taxes were paid or accrued, and not the year to which the foreign tax credits are carried. This is applicable for taxes paid or accrued in tax years beginning after August 5, 1997. See section 6511(d)(3)(A).
- For transactions occurring in annual accounting periods after August 5, 1997, the penalty for failure to report information under section 6038 has increased to \$10,000 for each CFC per reporting period. An additional \$10,000 penalty (with a maximum of \$50,000) may apply if the failure continues after notice from the IRS. See section 6038(b).

Other changes.

- Final regulations under section 905(b) were issued effective January 26, 1998. The regulations provide guidance regarding what is required to substantiate claims for foreign tax credit. See Regulations section 1.905-2.
- A separate Form 1118 must be completed for section 901(j) income and taxes from each sanctioned country. See **Section 901(j) Income** on page 3.
- Separate Forms 1118 must be completed for income that is treated as foreign-source income under an income tax treaty. See **Income Re-sourced by Treaty** on page 3.

- Income sourced under section 863(b) is aggregated, rather than reported by country, on Schedule A. Information about this income is no longer required to be reported on Schedule F.
- Part II of Schedule C has been divided into Parts II and III. Part II is used for reporting foreign taxes deemed paid under section 902 with respect to dividends paid out of pre-1987 accumulated profits. Part III is used for reporting foreign taxes deemed paid under section 960 with respect to deemed inclusions from pre-1987 earnings and profits.
- Schedule D has been divided into two parts and is used for reporting foreign taxes deemed paid under section 902(b) by first- and second-tier foreign corporations.
- Schedule E has been divided into three parts and is used to report foreign taxes deemed paid by certain third-, fourth-, and fifth-tier foreign corporations.

General Instructions

Purpose of Form

Use Form 1118 to compute a corporation's foreign tax credit for certain taxes paid or accrued to foreign countries or U.S. possessions. See **Taxes Eligible for a Credit** on page 3. Use a **separate** Form 1118 to compute the foreign tax credit for **each** of several statutory categories of income. See **Categories of Income** on page 2.

Who Must File

Any corporation that elects the benefits of the foreign tax credit under section 901 must complete and attach Form 1118 to its income tax return.

When to Make the Election

The election to claim the foreign tax credit (or a deduction in lieu of a credit) for any tax year may be made or changed at any time before the end of a special 10-year period described in section 6511(d)(3) (or section 6511(c) if the period is extended by agreement).

Computer-Generated Form 1118

The corporation may submit a computer-generated Form 1118 and schedules if they conform to the IRS version. However, if a software program is used, it must be approved by the IRS for use in filing substitute forms. This

ensures the proper placement of each item appearing on the IRS version. For more information, get **Pub. 1167**, Substitute Printed, Computer-Prepared and Computer-Generated Tax Forms and Schedules.

How to Complete Form 1118

Important: Complete a separate Schedule A; Schedule B, Parts I & II; Schedules C through G; and Schedule I for each applicable separate category of income. Complete Schedule B, Part III; Schedule H; and Schedule J only once.

- Use **Schedule A** to compute the corporation's income or loss before adjustments separately for each applicable category of income.
- Use **Schedule B** to determine the total foreign tax credit after certain limitations.
- Use **Schedule C** to compute taxes deemed paid by the domestic corporation filing the return.
- Use **Schedules D and E** to compute taxes deemed paid by lower-tier foreign corporations.
- Use **Schedule F** to compute gross income and definitely allocable deductions from foreign branches.
- Use **Schedule G** to compute required reductions of tax paid, accrued, or deemed paid.
- Use **Schedule H** to apportion deductions that cannot be definitely allocated to some item or class of income.
- Use **Schedule I** (a separate schedule) to report reductions of taxes paid, accrued, or deemed paid on foreign oil and gas extraction income.
- Use **Schedule J** (a separate schedule) to compute adjustments to the separate limitation income (loss) categories for determining the numerators of limitation fractions, year-end recharacterization balances, and overall foreign loss account balances.

Categories of Income

A separate foreign tax credit limitation must be computed for income received in each separate category described below.

Passive Income

Generally, passive income is:

- Any income received or accrued that would be foreign personal holding company income (defined in section 954(c)) if the corporation was a controlled foreign corporation (CFC) (defined in section 957). This includes any gain on the sale or exchange of stock that is more than the amount treated as a dividend under section 1248. However, in determining if any income would be foreign personal holding company income, the rules of section 864(d)(6) will apply only for income of a CFC; and
- Any amount includible in gross income under sections 551 and 1293 (which relate to foreign personal holding companies and certain passive foreign investment companies).

Passive income does **not** include:

- Any income that belongs in one of the other income categories described below;
- Any export financing interest unless it is also related person factoring income (under section 904(d)(2)(G) and Regulations section 1.904-4(h)(3));
- Any high-taxed income (see **General Limitation Income**); below or
- Any active rents or royalties. See Regulations section 1.904-4(b)(2) for definitions and exceptions.

Note: Certain income received from a CFC that would otherwise be passive income may be assigned to another separate category under the look-through rules. See **Look-Through Rules for CFCs** on page 3.

High Withholding Tax Interest

High withholding tax interest is any interest subject to a withholding tax or other gross basis tax of a foreign country or U.S. possession at a rate of 5% or more.

High withholding tax interest does **not** include export financing interest (section 904(d)(2)(B)(ii)).

Financial Services Income

Financial services income is income received or accrued while the corporation was a financial services entity if the income is:

- Described in section 904(d)(2)(C)(ii);
- Passive income (determined without regard to section 904(d)(2)(A)(iii)(I) and (III));
- Export financing income (section 904(d)(2)(G)) that would be high withholding tax interest but for section 904(d)(2)(B)(ii); or
- Incidental income described in Regulations section 1.904-4(e)(4).

Financial services income does **not** include:

- Any high withholding tax interest;
- Any dividend from a noncontrolled section 902 corporation; and
- Any export financing interest not described in section 904(d)(2)(C)(i)(III).

Important: If the corporation qualified as a financial services entity because it treated certain amounts as active financing income that are not listed in Regulations sections 1.904-4(e)(2)(i)(A) through (X), but that are described as similar items in Regulations section 1.904-4(e)(2)(i)(Y), attach a statement to Form 1118 showing the types and amounts of the similar items.

Shipping Income

Shipping income is any income the corporation receives or accrues that is of a kind that would be foreign base company shipping income (section 954(f)).

Shipping income does **not** include any dividends from a noncontrolled section 902 corporation; financial services

income; high withholding tax interest; or foreign trade income.

Dividends From EACH Noncontrolled Section 902 Corporation

Dividends from **each** noncontrolled section 902 corporation are treated as a separate category of income. A noncontrolled section 902 corporation is any foreign corporation in which the corporation meets the stock ownership requirements of section 902(a) (or, in applying section 904(d)(3), the requirements of section 902(b)).

A CFC is not treated as a noncontrolled section 902 corporation for any distribution out of its earnings and profits (E&P) for periods when it was a CFC. For distributions on or before August 5, 1997, the filing corporation must also have been a U.S. shareholder in the CFC when the E&P was earned. Dividends received by a CFC are assigned to a separate category of income under the look-through rules. Exceptions apply. See **Look-Through Rules for CFCs** on page 3.

Also, see the special rule in section 904(d)(2)(E)(ii) that reduces the creditable taxes on high withholding tax interest of a noncontrolled section 902 corporation. Report the reduction on Schedule G.

Dividends From a DISC or Former DISC

This category includes dividends from a DISC or former DISC (section 992(a)) that are treated as income from sources outside the United States.

Taxable Income Attributable to Foreign Trade Income

This category includes taxable foreign trade income within the meaning of section 923(b).

Certain Distributions From a FSC or Former FSC

This category includes:

- Distributions of E&P from foreign trade income of a FSC (or former FSC); and
- Interest or carrying charges from a transaction that results in foreign trade income.

General Limitation Income

This category includes all income not described above. Be sure to include high-taxed income that would otherwise be passive income. See Regulations section 1.904-4(c). Usually, income is high-taxed if the total foreign income taxes paid, accrued, or deemed paid by the taxpayer for that income exceed the highest rate of tax specified in section 1 or 11, whichever applies (and with reference to section 15, if applicable), multiplied by the amount of such income (including the amount treated as a dividend under section 78).

Section 901(j) Income

No credit is allowed for foreign taxes paid to certain sanctioned countries (as described in section 901(j)(2)). Income derived from **each** such country is subject to a separate foreign tax credit limitation. As of the date these instructions were revised, sanctioned countries include Cuba, Iran, Iraq, Libya, North Korea, Sudan, and Syria.

If the corporation paid taxes to a country that ceased to be described in section 901(j) during the tax year, see Rev. Rul. 92-62, 1992-2 C.B. 193, for details on how to figure the foreign tax credit for the period that begins after the end of the sanctioned period.

Income Re-sourced by Treaty

If a sourcing rule in an applicable income tax treaty treats any of the income described below as foreign source, and the corporation elects to apply the treaty, the income will be treated as foreign source.

- Dividends eligible for the dividends received deduction (section 245(a)(10));
- 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: *The corporation must compute a separate foreign tax credit limitation for any such income for which it claims benefits under a treaty, using a separate Form 1118 for each amount of re-sourced income from a treaty country.*

Look-Through Rules for CFCs

Generally, dividends, interest, rents, and royalties are passive income. However, if these items and subpart F inclusions under section 951(a)(1)(A) are received or accrued from a CFC, they may be assigned to other income categories under the look-through rules of section 904(d)(3). This includes:

- Subpart F income inclusions to the extent attributable to E&P of the CFC in a separate category;
- Interest, rents, and royalties based on the amount allocable to E&P of the CFC in a separate category; and
- Dividends paid out of the E&P of a CFC in proportion to the ratio of the CFC's E&P in a separate category to its total E&P.

For more information and examples see section 904(d)(3) and Regulations section 1.904-5.

Special Rules for Income

Source Rules

Determine income or (loss) for each separate category before adjustments on Schedule A using the general source rules of sections 861 through 865 and related regulations; the special source

rules of section 904(g) described below; and any applicable source rules contained in any applicable tax treaties.

Usually, the following income from a U.S.-owned foreign corporation, otherwise treated as foreign source income, must be treated as U.S. source income under section 904(g):

- Any subpart F income, foreign personal holding company income, or income from a qualified electing fund that a U.S. shareholder is required to include in its gross income, if such amount is attributable to the U.S.-owned foreign corporation's U.S. source income;
- Interest that is properly allocable to the U.S.-owned foreign corporation's U.S. source income; and
- Dividends equal to the U.S. source ratio (defined in section 904(g)(4)(B)).

The rules regarding interest and dividends described above do not apply to a U.S.-owned foreign corporation if less than 10% of its E&P for the tax year is from U.S. sources.

Capital Gains

The separate limitation income or (loss) before adjustments should generally include gain from the sale or exchange of capital assets only up to the amount of foreign source capital gain net income (which is the smaller of capital gain net income from sources outside the United States or capital gain net income). Therefore, if the corporation has capital gain net income from sources outside the United States in excess of the capital gain net income reported on its tax return, enter the excess on Schedule A, column 9(d) as a negative number.

See section 904(b)(2)(B) for special rules regarding capital gain rate differential (as defined in section 904(b)(3)(D)) for any tax year. At the time these instructions went to print, there was no capital gain rate differential.

Coordination with Section 936

In computing the foreign tax credit limitation, exclude from taxable income any income taken into account in computing the possessions corporation tax credit under section 936 (without regard to sections 936(a)(4) and 936(i) or section 30A).

Credit Limitations

Taxes Eligible for a Credit

Generally, a domestic corporation can claim a foreign tax credit (subject to the limitation of section 904) for the following taxes:

- Income, war profits, and excess profits taxes (defined in Regulations section 1.901-2) paid or accrued during the tax year to any foreign country or U.S. possession;
- Taxes deemed paid under sections 902 and 960; and

- Taxes paid in lieu of income taxes as described in section 903 and Regulations section 1.903-1.

Some foreign taxes that are otherwise eligible for the foreign tax credit must be reduced. These reductions are reported on Schedule G.

Important: *A corporation may not claim a foreign tax credit for foreign taxes paid to a foreign country that it does not legally owe, including amounts eligible for refund by the foreign country. If a corporation does not exercise its available remedies to reduce the amount of tax to what it legally owes, a credit is not allowed for the excess amount.*

Credit or Deduction

A corporation may choose to take either a credit or a deduction for eligible foreign taxes paid or accrued. The choice is made annually. Generally, under section 275 and Regulations sections 1.901-1(c) and (h), if a corporation elects the benefits of the foreign tax credit for any tax year, no portion of the foreign taxes will be allowed as a deduction in that year or any subsequent tax year.

However, a corporation that elects the credit may be allowed a deduction for certain taxes for which a credit was not allowed. These include:

- Taxes for which the credit was denied because of the boycott provisions of section 908;
- Certain taxes on foreign oil related income under section 907(b);
- Certain taxes on the purchase or sale of oil or gas (section 901(f));
- Taxes paid on foreign trade income (section 901(h));
- Certain taxes used to provide subsidies (section 901(i));
- Taxes paid to certain foreign countries for which a credit was denied under section 901(j); and
- Taxes paid on dividends if a minimum holding period is not met with respect to the underlying stock (section 901(k)).

No Credit or Deduction

No foreign tax credit (or deduction even if a credit is not claimed) is allowed for certain taxes including:

- Certain taxes paid on distributions from possessions corporations (section 901(g));
- Taxes on foreign oil and gas extraction income that were reduced under section 907(a);
- Taxes on mineral income that were reduced under section 901(e);
- Taxes paid or accrued to a foreign country or U.S. possession on taxable income that is taken into account in computing the possessions corporation tax credit described in section 936 or 30A; and
- Taxes attributable to income excluded under section 814(a) (relating to contiguous country branches of domestic life insurance companies).

Note: A regulated investment company that has made an election under section 853 cannot claim the foreign tax credit (or take a deduction) for foreign taxes paid.

Carryback and Carryover of Excess Foreign Taxes

If the allowable foreign taxes paid, accrued, or deemed paid in a tax year in a separate category exceeds the foreign tax credit limitation for the tax year for that separate category, the excess may be carried back 2 years and then forward 5 years to offset taxes imposed on income in the same separate category. The excess is applied first to the earliest of the 7 years to which it may be carried, then to the next earliest year, etc. If the corporation did not take a credit in one of the 7 tax years to which the excess may be carried, the excess is considered used in that year as though the credit had been claimed. See section 904(c) and Regulations section 1.904-2 for more details.

How to claim the excess credit. If the corporation is carrying back the excess credit to an earlier year, file an amended tax return with a revised Form 1118. Attach the statement described in Regulations section 1.904-2(f) for each tax year to which the corporation is carrying back or carrying forward the excess credit.

Special rules apply to:

- The carryback and carryover of foreign taxes paid or accrued on foreign oil and gas extractions or related taxes (see section 907(f)); and
- An excess foreign tax credit carried to a tax year beginning after September 30, 1993, if an excess limitation account was established under section 960(b)(2).

Foreign Corporations Claiming the Credit

Foreign corporations are allowed a foreign tax credit for income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued under section 902) to any foreign country or U.S. possession for income effectively connected with the conduct of a trade or business within the United States. The credit is not applicable, however, if a foreign country or U.S. possession imposes the tax on income from U.S. sources solely because the foreign corporation was created or organized under the law of the foreign country or U.S. possession or is domiciled there for tax purposes.

The credit cannot be taken against any tax imposed on income not effectively connected with a U.S. business.

In computing the foreign tax credit limitation, the foreign corporation's taxable income includes only the taxable income that is effectively connected with the conduct of a trade or business within the United States (section 906(b)(2)).

A foreign corporation claiming a foreign tax credit will be treated as a domestic corporation for tax deemed paid (section 902(a)) and dividend gross-up (section 78).

Definition of Foreign Corporation for Purposes of the Deemed Paid Credit

In computing the deemed paid credit on Schedules C, D, and E, the term "foreign corporation" includes:

- A DISC or former DISC, but only for dividends from the DISC or former DISC that are treated as income from sources outside the United States; and
- A contiguous country life insurance branch that has made an election to be treated as a foreign corporation under section 814(g).

Proof of Credits

Form 1118 must be carefully filled in with all the information called for and with the calculations of credits indicated.

Important: Documentation (e.g., receipts of payments or a foreign tax return for accrued taxes) is not required to be attached to Form 1118. However, proof **must** be presented upon request by the IRS to substantiate the credit. See Regulations section 1.905-2.

If the corporation claims a foreign tax credit for tax accrued but not paid, the IRS may require a bond to be furnished on **Form 1117**, Income Tax Surety Bond, before the credit is allowed. See Regulations section 1.905-2(c).

Foreign Tax Credit Redeterminations

The corporation's foreign tax credit must be redetermined if:

- Accrued foreign taxes when paid differ from the amounts claimed as credits;
- Accrued foreign taxes that relate to tax years beginning after 1997 are not paid within 2 years after the close of the tax year to which they relate; or
- Any foreign tax paid is fully or partially refunded.

Reporting Requirements

If any of the above occurs, the corporation generally must redetermine its U.S. tax liability. To do this, the corporation must:

- File an amended return and Form 1118 with the Service Center where it filed the tax return on which it claimed the affected foreign tax credit.
- Provide identifying information such as the corporation's name, address, employer identification number (EIN), and the tax year or years that are affected by the redetermination.

Additional information required. If the redetermination was because of one of the following, the corporation must provide the information as indicated.

- **Refund of foreign taxes paid—**

1. The date or dates on which the foreign taxes were paid;
2. The amount of foreign taxes paid on each date (in foreign currency);
3. The exchange rate on each date the foreign taxes were paid; and
4. The amount of foreign taxes refunded (in foreign currency).

• **Foreign taxes that when paid differ from the accrued amounts claimed as credits for a year beginning before 1998—**

1. The date on which the foreign taxes were accrued;
2. The dates on which the foreign taxes were paid;
3. The exchange rate for each date the foreign taxes were accrued and paid; and
4. The amount of foreign taxes accrued or paid on each such date (in foreign currency).

• **Foreign taxes that when paid differ from accrued amounts claimed as credits for a tax year beginning after 1997 because the corporation paid more or less foreign tax than was originally accrued or failed to pay accrued taxes within 2 years—**

1. The date on which the foreign taxes were accrued;
2. The dates on which the foreign taxes were paid;
3. The average exchange rate for the year for which the foreign taxes were accrued;
4. For taxes paid more than 2 years after the year to which they relate, the exchange rate at the time of payment; and
5. The amount of tax accrued or paid for each such date, and the amount of accrued tax that was not paid within 2 years (in foreign currency).

• **Foreign taxes deemed paid or accrued under section 902 or section 960—**Include the following basic information as an attachment to the tax return for the year for which the redetermination applies:

1. The dates and amounts of any dividend distributions or other inclusions from E&P for the affected year or years;
2. The amount of E&P from which such dividends were paid for the affected years or years; and
3. The information described above for foreign taxes paid or accrued, as applicable.

• **Foreign taxes deemed paid or accrued under section 902 or section 960—**Include the following basic information as an attachment to the tax return for the year for which the redetermination applies:

1. The dates and amounts of any dividend distributions or other inclusions from E&P for the affected year or years;
2. The amount of E&P from which such dividends were paid for the affected years or years; and
3. The information described above for foreign taxes paid or accrued, as applicable.

Redetermination NOT Required

If foreign taxes deemed paid under section 902 or section 960 are adjusted and the corporation is not required to redetermine its U.S. tax liability, adjust the appropriate pools of foreign taxes and E&P using the rules outlined in Temporary Regulations section 1.905-3T(d)(2)(ii).

If an adjustment to the appropriate pools of foreign taxes and E&P is required, attach a notice of the adjustment to the tax return for the tax year during

which the foreign tax adjustment occurs. Provide the following information:

- The corporation's name and EIN;
- The foreign corporation's name, address, and EIN (if any);
- The amount of any refunds of foreign taxes and the exchange rate originally used to translate the refunded foreign taxes;
- The amounts of unrefunded foreign taxes when paid and when accrued in foreign currency, the exchange rates applicable to the unrefunded foreign taxes, and the dollar amounts of unrefunded foreign taxes paid and accrued; and
- The current balances of the pools of E&P and foreign taxes before and after the foreign tax adjustment.

If an adjustment relates to a foreign tax overaccrual of 2% or more, identify each such adjustment and include a complete factual description justifying the reasons for the overaccrual (Temporary Regulations section 1.905-3T(d)(2)(iii)).

If the corporation fails to attach the required notice, to provide the necessary information, or to make the required adjustments, it must provide notification of the foreign tax changes under Temporary Regulations section 1.905-4T. The notification must include a complete factual description justifying the reasons for the failure to attach the required notification or make the required adjustments. The IRS may, in its discretion, make a redetermination of the corporation's U.S. tax liability and apply the interest provisions of section 6601 and the penalty provisions of section 6689.

Important: *Temporary Regulations section 1.905-3T(d)(2)(ii)(A) has been suspended, as well as that portion of Regulations section 1.905-3T(d)(2)(ii)(C) that refers to Regulations section 1.905-3T(d)(2)(ii)(A). These suspensions are effective for taxes deemed paid or accrued for E&P of a foreign corporation accumulated in tax years beginning after 1986.*

Until final regulations are issued under section 905(c), redeterminations otherwise subject to those regulations sections must be accounted for through adjustment to the appropriate pools of E&P and foreign taxes as described in Temporary Regulations section 1.905-3T(d)(3) and subject to the exceptions in Temporary Regulations section 1.905-3T(d)(4). See Notice 90-26, 1990-1 C.B. 336, for details.

Interest and Penalties

In most cases, interest is computed on the deficiency or overpayment that resulted from the foreign tax adjustment (sections 6601 and 6611 and the related regulations). See Temporary Regulations section 1.905-4T(c) for additional information.

If the corporation does not comply with the requirements discussed above within the time for filing specified, the penalty

provisions of section 6689 (and the related regulations) will apply.

Treaty-Based Return Positions

Corporations that adopt a return position that any U.S. treaty overrides or modifies any provision of the Internal Revenue Code, and causes (or potentially causes) a reduction of any tax incurred at any time, generally must disclose this position. Complete **Form 8833**, Treaty-Based Return Position Disclosure Under Section 6114 or Section 7701(b) and attach it to Form 1118. See section 6114 and Regulations section 301.6114-1 for details.

Failure to make such a report may result in a \$10,000 penalty.

Specific Instructions

Report all amounts in U.S. dollars unless otherwise specified. If it is necessary to convert from a foreign currency, attach a statement explaining how the conversion rate was determined.

Important: *Use a separate Form 1118 to compute (1) the foreign taxes paid or accrued for each separate income category; (2) section 901(j) income and taxes for each sanctioned country; and (3) each amount of re-sourced income from a treaty country.*

See Categories of Income on page 2 for descriptions. For Section 901(j) income and taxes and re-sourced income from a treaty country, identify the applicable country in the space provided.

Noncontrolled Section 902 Corporations

If the corporation has dividends from more than one noncontrolled section 902 corporation, complete a **separate** Form 1118 for dividends received from **each** of those corporations. Each separate form must identify the name and country of incorporation of each noncontrolled section 902 corporation in the space provided. Complete part of an additional Form 1118 that shows the totals of all the separate Forms 1118 for each noncontrolled section 902 corporation. On page 1 of this summary form, enter the word "Aggregate" in the space provided for "Name of Foreign Corporation" at the top of the form and complete Schedule A and Schedule B, Part I.

Schedule A

Report gross income or (loss) from sources outside the United States for the applicable income category in columns 2 through 7. Gross income equals gross receipts reduced by cost of goods sold. Report the applicable deductions to this gross income in columns 9 and 10. Be sure to include in all columns the gross income and deductions that pertain to foreign branches.

Aggregate **all** section 863(b) gross income and deductions and report the totals on a single line.

Column 1. Enter the two-letter codes (from the list beginning on page 11) of all foreign countries and U.S. possessions within which income is sourced and/or to which taxes were paid, accrued, or deemed paid.

For section 863(b) income, enter "863(b)" instead of a two-letter code.

Column 2(a). If the corporation is a U.S. shareholder in a CFC, report all income deemed received under section 951(a)(1)(A) (before gross-up). See section 904(d)(3) and **Look-Through Rules for CFCs** on page 3 for more information. If the corporation is a U.S. shareholder in a passive foreign investment company (PFIC) and receives distributions from stock in that PFIC, report all income deemed received (before gross-up) under section 1291.

Column 3(a). Report all other dividends (before gross-up) not included in column 2(a) from sources outside the United States from the applicable separate income category.

Note: *All dividends from a domestic corporation are of U.S. source, including dividends from a domestic corporation which has 80% or more of its gross income from sources outside the United States.*

Columns 2(b) and 3(b). Include taxes deemed paid by a domestic corporation under section 902 or section 960 on distributions by a foreign corporation in income as dividend gross-up. See Regulations section 1.960-3(b) for exceptions.

Column 4. Enter all interest received from foreign sources. See section 861(c) for the treatment of interest from a domestic corporation that meets the foreign business requirement.

Column 6. Include gross income, including compensation, commissions, fees, etc., for technical, managerial, engineering, construction, scientific, or similar services outside the United States. Be sure to include gross income from services performed through a foreign branch.

Column 7. Include all other gross income from sources outside the United States for the applicable income category. Attach a schedule identifying the gross income by type and by the foreign country or U.S. possession from which it was sourced. Also include all other gross income of foreign branches.

Column 9(d). Include all other deductions definitely allocable to income from sources outside the United States (dividends, interest, etc.) for the applicable income category. Include deductions allocable to income of foreign branches.

Include any reduction of foreign source net capital gain. If foreign source net capital gain is more than the net capital gain reported on the corporation's tax

return, enter the excess as a negative number. See **Capital gains** on page 3.

Column 10. Enter only the apportioned share from Schedule H, Part II, Column (d) that relates to gross income reported in columns 2 through 7.

Schedule B

Part I—Foreign Taxes Paid, Accrued, and Deemed Paid

Report only foreign taxes paid, accrued, or deemed paid for the separate income category for which this Form 1118 is being completed. If any foreign taxes paid or accrued resulted from an audit adjustment made by a foreign taxing authority, attach a statement identifying the taxes.

Column 1. Claim the foreign tax credit for the tax year in which the taxes were paid or accrued, depending on the method of accounting used. If a credit for taxes accrued is claimed, show both the date accrued and the date paid (if paid).

If the cash method of accounting is used, an election under section 905(a) can be made to claim the credit based on accrued taxes. If this election is made, figure the foreign tax credit for all subsequent tax years on the same basis. Also, the credits are subject to the redetermination provisions of section 905(c).

Column 2(d). Include foreign taxes paid or accrued on foreign branch taxable income to which the rules of section 863(b) apply.

Note: Do not include these overlapping amounts in column 2(e).

Part II—Separate Credit Limitation

Line 4. Enter the total amount of foreign taxes carried forward or back to the current year. Include all taxes carried forward, whether or not such taxes are used. Attach a schedule reconciling the prior year's carryover with this year's carryover, identifying carrybacks and any other adjustments.

Line 6. See the instructions for **Schedule J** to determine if that schedule must be filed.

Line 7b. Enter taxable income that should not be taken into account in computing the foreign tax credit limitation. For example, enter the income taken into account in computing the possessions corporation tax credit under section 936 (without regard to sections 936(a)(4) and 936(i)) or section 30A.

Line 8. Divide line 6 by line 7c to determine the limitation fraction. Enter the fraction on line 8 as a decimal with the same number of places as the number of digits to the left of the decimal in adjusted taxable income on line 7c. For example, if adjusted taxable income on line 7c is \$100,000, compute the limitation fraction to 6 decimal places.

Line 10. The limitation may be increased under section 960(b) for any tax year that the corporation receives a distribution of previously taxed E&P. See section 960(b).

Part III—Summary of Separate Foreign Tax Credit Limitations

Complete Part III only once. Enter on lines 1 through 10 the separate foreign tax credits from Part II, line 11 for each applicable separate income category.

Line 12. If the corporation participates in or cooperates with an international boycott, the foreign tax credit may be reduced. Complete **Form 5713**, International Boycott Report. If the corporation chooses to apply the international boycott factor to calculate the reduction in the credit, enter the amount from line 2a(3) of Schedule C (Form 5713) on line 12.

Schedule C

Part I—Dividends and Inclusions From Post-1986 Undistributed Earnings

Column 1. Enter the name of the foreign corporation (or DISC or former DISC) whose earnings were distributed to, or included in income by, the domestic corporation filing the return.

Column 2. Enter the year and month in which the foreign corporation's tax year ended.

Example. When figuring foreign taxes deemed paid in 1998 by a calendar year domestic corporation with respect to dividends and inclusions out of post-1986 undistributed earnings for the foreign corporation's tax year that ended June 30, 1998, enter "9806."

Column 4. Enter the distributing corporation's post-1986 undistributed earnings pool for the separate income category for which the schedule is filed. Generally, this amount is the corporation's E&P (computed in the corporation's functional currency according to sections 964(a) and 986) accumulated in tax years beginning after 1986, determined as of the close of the corporation's tax year without reduction for any earnings distributed or otherwise included in income (e.g., under section 304, 367(b), 551, 951(a), 1248, or 1293) during the tax year.

Post-1986 undistributed earnings are reduced to account for distributions or deemed distributions that reduced E&P and inclusions that resulted in previously taxed amounts described in section 959(c)(1) and (2) or section 1293(c) in prior tax years beginning after 1986. See Regulations section 1.902-1(a)(9). Also, see section 902(c)(3) and Regulations section 1.902-1(a)(11) for special rules treating earnings accumulated in post-1986 years as pre-1987 accumulated profits when no U.S.

shareholder was eligible to claim a section 902 credit with respect to taxes paid by the foreign corporation.

Column 5. Enter the opening balance in the distributing corporation's post-1986 foreign income taxes pool for the tax year indicated. This amount is the foreign income taxes paid, accrued, or deemed paid (in U.S. dollars) by the foreign corporation for prior tax years beginning after 1986, reduced by foreign taxes attributable to distributions or deemed inclusions of earnings in prior tax years. See Regulations section 1.902-1(a)(8)(i).

Column 6(a). Enter the foreign income taxes paid or accrued by the foreign corporation for the tax year indicated, translated into U.S. dollars using the exchange rate specified in section 986(a).

Column 6(b). Enter the foreign income taxes deemed paid (under section 902(b)) by the corporation for the tax year indicated (from Schedule D, Part I, Section A, column 10, and Section B, column 8(b)).

Column 8(a). Report the sum (in the foreign corporation's functional currency) of all dividends paid and deemed inclusions out of post-1986 undistributed earnings for the tax year indicated.

Column 8(b). Report the column 8(a) amounts, translated into U.S. dollars at the appropriate exchange rates (as defined in section 989(b)). If the foreign corporation's functional currency is the U.S. dollar, **do not** complete column 8(b).

Part II—Dividends Paid Out of Pre-1987 Accumulated Profits

Use a separate line for each dividend paid. If a dividend is paid out of the accumulated profits of more than one pre-1987 tax year, figure and show the tax deemed paid on a separate line for each tax year. In applying section 902, the IRS may determine from which tax year's accumulated profits the dividends were paid. See Regulations section 1.902-3(g)(4).

Important: The formula for calculating foreign taxes deemed paid under section 902 with respect to dividends paid in a post-1986 year out of pre-1987 accumulated profits requires that all components (dividends, accumulated profits, and taxes) be maintained in the foreign corporation's functional currency and translated into U.S. dollars at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(10)(ii) and (iii).

Column 1. Enter the name of the first-tier foreign corporation (or DISC or former DISC) that paid a dividend out of pre-1987 profits to the domestic corporation filing the return.

Column 2. Enter the year and month in which the foreign corporation's pre-1987 tax year ended.

Column 4. For each line, enter the pre-1987 accumulated profits (E&P) for the tax year indicated in column 2, computed in functional currency under

section 902. See Regulations section 1.902-1(a)(10)(i) and (ii).

Column 5. Enter the foreign taxes paid or deemed paid (in functional currency) with respect to the E&P entered in column 4 for the tax year indicated in column 2. See **Schedule G** on page 8 for information on reduction of foreign taxes for failure to furnish information required under section 6038.

Column 6(a). Enter the amount of each dividend paid by the first-tier foreign corporation (or DISC or former DISC) to the domestic corporation (in functional currency) out of the accumulated profits of the pre-1987 tax year indicated in column 2.

Column 6(b). Enter the amount from column 6(a) translated into U.S. dollars using the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(ii) and section 1.902-3(g)(1).

Column 8(a). Multiply column 5 by column 7. Enter this amount in column 8(a) in functional currency.

Column 8(b). Enter the amount from column 8(a) translated into U.S. dollars at the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(iii).

Part III—Deemed Inclusions From Pre-1987 Earnings and Profits

Important: *The formula for calculating foreign taxes deemed paid under section 960 with respect to deemed inclusions (e.g., under section 956 or 1248) in a post-1986 year out of pre-1987 E&P requires that earnings and profits and foreign taxes be calculated in U.S. dollars under the rules of Regulations section 1.964-1(a) through (e), and then translated into the foreign corporation's functional currency at the exchange rate in effect on the first day of the foreign corporation's first post-1986 tax year. See Notice 88-70, 1988-2 C.B. 369. The deemed inclusion is then translated into U.S. dollars at the appropriate exchange rate specified in section 989(b). Foreign income taxes paid in pre-1987 tax years are translated into U.S. dollars for purposes of section 960 at the exchange rate in effect when the foreign taxes were paid. See Regulations section 1.964-1(d) and Temporary Regulations section 1.905-5T(b)(1).*

Column 1. Enter the name of the first- or lower-tier foreign corporation whose earnings were deemed included in the income of the domestic corporation filing the return.

Column 2. Enter the year and month in which the corporation's pre-1987 tax year ended. If the deemed inclusion is from the accumulated E&P of more than 1 tax year, figure and show the tax deemed paid on a separate line for each year.

Column 4. For each line, enter the E&P calculated in U.S. dollars under Regulations sections 1.964-1(a) through (e), translated into functional currency

under Notice 88-70 for the tax year indicated in column 2.

Column 5. Enter foreign taxes paid and deemed paid (in U.S. dollars) with respect to the E&P entered in column 4. See **Schedule G** on page 8 for information on reduction of foreign taxes for failure to furnish information required under section 6038.

Column 6(b). Enter the amount from column 6(a) translated into U.S. dollars at the appropriate exchange rate specified in section 989(b).

Schedule D

Part I—Tax Deemed Paid by First-Tier Foreign Corporations

Section A—Dividends Paid Out of Post-1986 Undistributed Earnings

Column 1. Enter the name of the second-tier foreign corporation and the name of the first-tier foreign corporation to which it paid a dividend out of post-1986 undistributed earnings.

Example. The U.S. corporation filing the return owns all of the stock of CFC1 and CFC2. CFC1 and CFC2 each owns 50% of the stock of CFC3. In 1998, CFC3 pays a dividend to CFC1 and CFC2. Use one line to report dividends from CFC3 to CFC1 and another line to report dividends from CFC3 to CFC2.

Column 2. Enter the year and month in which the distributing second-tier foreign corporation's tax year ended.

Example. If a first-tier foreign corporation that uses the calendar year 1998 as its taxable year receives dividends out of post-1986 undistributed earnings of a second-tier foreign corporation for a tax year that ended June 30, 1998, enter "9806."

Column 3. Enter the second-tier foreign corporation's applicable two-digit foreign country or U.S. possession code from the list beginning on page 11.

Column 4. Enter the second-tier foreign corporation's post-1986 undistributed earnings pool (in functional currency) for the separate income category for which the schedule is filed. See the instructions for Schedule C, Part I, column 4.

Column 5. Enter the opening balance in the second-tier foreign corporation's post-1986 foreign income taxes pool for the tax year indicated. See the instructions for Schedule C, Part I, column 5.

Column 6(a). Enter the foreign income taxes paid or accrued by the second-tier foreign corporation for the tax year indicated, translated from foreign currency into U.S. dollars using the exchange rate specified in section 986(a).

Column 6(b). Enter the foreign income taxes deemed paid (under section 902(b)) by the second-tier foreign corporation for the tax year indicated (from Schedule D, Part II, Section A, column 10, and Part II, Section B, column 8(b)).

Column 8(a). Report the sum (in the second-tier foreign corporation's functional currency) of all dividends paid out of its post-1986 undistributed earnings for the tax year indicated.

Column 8(b). Report the sum of the column 8(a) amounts translated into the functional currency of the first-tier foreign corporation at the spot rate in effect on the date of each distribution.

Section B—Dividends Paid Out of Pre-1987 Accumulated Profits

Use a separate line for each dividend paid. If a dividend is paid out of the accumulated profits of more than one pre-1987 tax year, figure and show the tax deemed paid on a separate line for each tax year. In applying section 902, the IRS may determine from which tax year's accumulated profits the dividends were paid. See Regulations section 1.902-3(g)(4).

Important: *The formula for calculating foreign taxes deemed paid by a first-tier foreign corporation under section 902(b) with respect to dividends paid by a second-tier foreign corporation in a post-1986 year out of pre-1987 accumulated profits requires that all components (dividends, accumulated profits, and taxes) be maintained in the second-tier foreign corporation's functional currency. Dividends are translated into the first-tier foreign corporation's functional currency and added to its post-1986 undistributed earnings at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(9)(ii). Foreign taxes are translated into U.S. dollars, and added to the first-tier foreign corporation's post-1986 foreign income taxes, at the exchange rate in effect on the date of the dividend distribution. See Regulations section 1.902-1(a)(8)(ii).*

Column 1. Enter the name of the second-tier foreign corporation and the name of the first-tier foreign corporation to which it paid a dividend out of pre-1987 accumulated profits.

Column 2. For each pre-1987 tax year, enter the year and month in which the second-tier foreign corporation's tax year ended.

Column 4. For each line, enter the pre-1987 E&P for the tax year indicated in column 2, computed in the second-tier corporation's functional currency under section 902. See Regulations section 1.902-1(a)(10)(i) and (ii).

Column 5. Enter the foreign taxes paid and deemed paid under section 902(b) (in functional currency) with respect to the E&P entered in column 4 for the pre-1987 tax year indicated in column 2. See **Schedule G** on page 8 for information on reduction of foreign taxes for failure to furnish information required under section 6038.

Column 6(a). Enter each dividend paid by the second-tier foreign corporation (in functional currency) to the first-tier foreign corporation out of the accumulated profits

of the pre-1987 tax year indicated in column 2.

Column 6(b). Enter the amount from column 6(a), translated into the first-tier foreign corporation's functional currency using the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(ii) and section 1.902-1(g)(1).

Column 8(a). Multiply column 5 by column 7. Enter this amount in column 8(a).

Column 8(b). Enter the amount from column 8(a), translated in U.S. dollars at the spot exchange rate in effect on the date of distribution. See Regulations section 1.902-1(a)(10)(iii).

Part II—Dividends Deemed Paid by Second-Tier Foreign Corporation

Follow the instructions for the corresponding columns of Schedule D, Part I, substituting "second-tier foreign corporation" for references to the "first-tier foreign corporation" and "third-tier foreign corporation" for references to the "second-tier foreign corporation."

Note: In completing column 5, note that section 902(b) as in effect prior to the Taxpayer Relief Act of 1997 did not treat any foreign taxes as deemed paid by a third- or lower-tier foreign corporation with respect to dividends received from lower-tier foreign corporations.

Schedule E

Use Schedule E to report foreign taxes deemed paid with respect to dividends from certain fourth-, fifth-, and sixth-tier controlled foreign corporations out of earnings accumulated in tax years beginning after August 5, 1997. Follow the instructions for the corresponding columns of Schedule D, Part I, Section A, substituting references to the next lower-tier foreign corporation as appropriate.

The post-1986 undistributed earnings and taxes pools for the eligible CFCs begin on the first day of the CFC's first taxable year beginning after August 5, 1997. Earnings accumulated in taxable years beginning before August 6, 1997 will be treated as pre-1987 accumulated profits for section 902 purposes. See section 902(c)(6) and Regulations section 1.902-1(a)(10)(i). Foreign income taxes attributable to these pre-pooling profits must be reduced when the associated earnings are distributed. However, such taxes are not eligible for the deemed paid credit. See section 1.902-1(a)(10)(iii) and section 1113(c)(2) of the Taxpayer Relief Act of 1997.

Note: In completing Part III, column 5, note that, under section 902(b) as amended by the Taxpayer Relief Act of 1997, no taxes are deemed paid by a sixth- or lower-tier foreign corporation with respect to dividends received from lower-tier foreign corporations.

Schedule F

Enter the gross income and definitely allocable deductions for each foreign branch as indicated. For each foreign branch, attach an income statement, balance sheet, and schedule of remittances.

Schedule G

Line A. If the corporation claims a deduction for percentage depletion under section 613 with respect to any part of its foreign mineral income (as defined in section 901(e)(2)) for the tax year from foreign sources, any foreign taxes on that income must be reduced by the smaller of:

1. The foreign taxes minus the tax on that income; or
2. The tax on that income determined without regard to the deduction for percentage depletion minus the tax on that income.

The reduction must be made on a country-by-country basis (Regulations section 1.901-3(a)(1)). Attach a separate schedule showing the reduction.

Line C. If the corporation chooses to calculate the reduction in the foreign tax by identifying taxes specifically attributable to participation in or cooperation with an international boycott, enter the amount from Form 5713, Schedule C, Line 2b. See Form 5713 and its separate Schedule C and instructions.

Line D. Any domestic corporation that fails to furnish any return or any information in any return required under section 6038 by the due date is subject to a 10% reduction of the foreign taxes available for credit under sections 901, 902, and 960. If the failure continues for 90 days or more after the date of written notice by the IRS, an additional 5% reduction is made for each 3-month period or fraction thereof during which the failure continues after the 90-day period has expired. See section 6038(c) for limitations and special rules.

A \$10,000 penalty (\$1,000 for annual accounting periods beginning before August 6, 1997) is imposed for failing to supply the information for each CFC within the time prescribed under section 6038. If the required information is not submitted within 90 days after the IRS has mailed notice to the U.S. person, an additional \$10,000 penalty per corporation (\$1,000 for annual accounting periods beginning before August 6, 1997) is charged for every 30 days that the information is not submitted. The increase in any penalty under section 6038(b)(2) may not exceed \$50,000 (\$24,000 for annual accounting periods beginning before August 6, 1997).

See section 6038(c)(3) for rules coordinating these penalties.

Line E. Include the following:

1. The reduction described in section

904(d)(2)(E)(ii) for taxes deemed paid with respect to dividends from a noncontrolled section 902 corporation out of E&P attributable to interest subject to withholding in excess of a 5% rate; and

2. The reduction for foreign taxes on foreign oil related income under section 907(b).

Schedule H

Computer-Generated Schedule H

A computer-generated Schedule H may be filed if it conforms to the IRS version. In some cases, Schedule H can be expanded to properly apportion deductions. This applies in cases such as when the corporation:

- Has more than two product lines (under the sales method of apportioning R&D deductions);
- Owns an interest in more than one noncontrolled section 902 corporation;
- Has income from a section 901(j) country; or
- Elected under a tax treaty to treat income that would otherwise be U.S.-source as foreign-source income.

Part I—Research and Development Deductions

Use Part I to apportion the research and development (R&D) deductions that cannot be definitely allocated to some item or class of gross income. Use either the sales method or one of the gross income methods described in Regulations section 1.861-17.

Note: The line 4 totals will generally be less than the totals on lines 1 and 2 because the line 4 totals do not include the gross income and deductions that are implicitly apportioned to the residual grouping.

Column (a) Sales Method

Complete these columns only if the corporation elects the sales method of apportioning R&D deductions described in Regulations section 1.861-17(c). Enter in the spaces provided the three-digit SIC Code numbers (based upon the Standard Industrial Classification System) of the product lines to which the R&D deductions relate. See Regulations section 1.861-17(a)(2)(ii) and (iii) for details on choosing SIC codes and changing a product category.

Note: If the corporation has more than two product lines, see **Computer-Generated Schedule H** above.

Columns (a)(i) and (a)(iii)

Line 1. Enter the worldwide gross sales for the product lines.

Lines 3a through 3i. Enter the gross sales that resulted in gross income for each statutory grouping.

Columns (a)(ii) and (a)(iv)

Line 1. Enter the total R&D deductions connected with the product lines.

Line 2. Reduce the line 1 totals by legally mandated R&D (Regulations section 1.861-17(a)(4), and a 50% exclusive apportionment amount (Regulations section 1.861-17(b)(1)(i)).

The legally mandated R&D rules apply to R&D undertaken solely to meet legal requirements imposed by a particular political entity for improvement or marketing of specific products or processes **IF** the corporation does not reasonably expect the results of that research to generate gross income (beyond de minimis amounts) outside a single geographic source.

Under the exclusive apportionment rules, 50% of the R&D deductions are apportioned exclusively to the statutory grouping of gross income, or the residual grouping of gross income, as the case may be, from the geographic source where the R&D activities which account for more than 50% of the amount of such deduction were performed. If the 50% test is **not** met, then no part of the deduction is apportioned under these rules.

Lines 3a through 3i. To figure the amount of R&D deductions to apportion to each statutory grouping, divide the gross sales apportioned to the statutory grouping by the worldwide gross sales for the product line. Multiply the result by the R&D deductions to be apportioned.

Note: *If the corporation owns an interest in more than one noncontrolled section 902 corporation, had income from a section 901(j) country, or elected under a tax treaty to treat U.S.-source as foreign-source income, see Computer-Generated Schedule H on page 8.*

Example 1. To determine the amount to enter on line 3a, column (a)(ii):

1. Divide the amount on line 3a, column (a)(i) by the amount on line 1, column (a)(i).

2. Multiply the result by the amount on line 2, column (a)(ii).

Example 2. To determine the amount to enter on line 3b, column (a)(iv):

1. Divide the amount on line 3b, column (a)(iii) by the amount on line 1, column (a)(iii).

2. Multiply the result by the amount on line 2, column (a)(iv).

Column (b) Gross Income Methods

Complete these columns only if the corporation elects one of the gross income methods of apportioning R&D deductions described in Regulations section 1.861-17(d)(2) and (3). Check the box for the option used. Use Option 1 only if certain conditions are met. See Regulations section 1.861-17(d)(2).

Column (b)(vi)

Line 1. Enter the total gross income (excluding exempt income according to Temporary Regulations section 1.861-8T(d)(2)).

Lines 3a through 3i. Enter the gross income within each statutory grouping.

Column (b)(vii)

Line 1. Enter the total R&D deductions.

Line 2. Reduce the line 1 totals by legally mandated R&D (section 1.861-17(a)(4)), and a 25% exclusive apportionment amount (section 1.861-17(b)(1)(ii)).

Lines 3a through 3i. If Option 1 is checked, divide the gross income apportioned to the statutory grouping by the total gross income and multiply the result by the R&D deductions to be apportioned. If Option 2 is checked, enter the appropriate amount as described in Regulations section 1.861-17(d)(3).

Part II—Interest Deductions, All Other Deductions, and Total Deductions

Note: *The line 4 totals will generally be less than the totals on lines 1 and 2 because the line 4 totals do not include the gross income and deductions that are implicitly apportioned to the residual grouping.*

Columns (a)(i) through (b)(iv)

Use these columns to apportion the interest deductions. See Temporary Regulations sections 1.861-8T through 1.861-13T for rules on the apportionment of interest deductions. Columns (a) and (b) are subdivided into “Nonfinancial Corporations” and “Financial Corporations.” In allocating interest deductions, members of an affiliated group that are financial corporations must be treated as a separate affiliated group. Complete columns (a)(ii) and (b)(iv) for members of the corporation’s affiliated group that are financial corporations and columns (a)(i) and (b)(iii) for members that are nonfinancial corporations.

Columns (a)(i) and (a)(ii)

Line 1a. Enter the average of the total assets of the affiliated group. See Temporary Regulations section 1.861-9T(g)(2) for the definition of average for these purposes.

Line 1b. Enter the assets included on line 1a that are characterized as excess related party indebtedness. See Temporary Regulations section 1.861-10T(e) for an exception to the general rule of fungibility for excess related party indebtedness.

Line 1c. Enter all other assets that attract specifically allocable interest deductions. See Temporary Regulations section 1.861-10T for other exceptions to the general rule of fungibility (such as qualified nonrecourse indebtedness and integrated financial transactions).

Line 1d. Enter the total of the exempt assets and assets without directly identifiable yield that are to be excluded from the interest apportionment formula (Temporary Regulations sections 1.861-8T(d)(2) and 1.861-9T(g)(3)).

Lines 3a through 3k. The assets on line 2 are characterized as assets in one of the statutory groupings or as belonging to the residual grouping. Enter the value of the assets in each of the statutory groupings on line 3a through 3k. See Temporary Regulations sections 1.861-9T(g)(3), 1.861-12T(g)(2), and 1.861-12T(h)(2) for the rules for characterizing the assets.

Columns (b)(iii) and (b)(iv)

Line 1a. Enter the total interest deductions for the members of the corporation’s affiliated group. These include any expense that is currently deductible under section 163 (including original issue discount), and interest equivalents. See Temporary Regulations section 1.861-9T for the definition of interest equivalents and a list of the sections that disallow or suspend interest deductions or require the capitalization of interest deductions.

Line 1b. Enter the interest deductions associated with the assets on line 1b of columns (a)(i) and (a)(ii), respectively, that attract specifically allocable interest deductions under Temporary Regulations section 1.861-10T(e).

Note: *These interest deductions will be divided among the statutory groupings and will appear as a definitely allocable deduction in Schedule A, column 9(d).*

Line 1c. Enter the interest deductions associated with the assets on line 1c of columns (a)(i) and (a)(ii), respectively, that attract specifically allocable interest deductions.

Lines 3a through 3k. To figure the amount of interest deductions to apportion to each statutory grouping, divide the assets apportioned to the grouping by the total assets apportioned and multiply the result by the interest deductions to be apportioned.

Example 1. To figure the amount to enter on line 3a, column (b)(iii): **(1)** divide the amount entered on line 3a, column (a)(i) by the amount on line 2, column (a)(i); and **(2)** multiply the result by the amount on line 2, column (b)(iii).

Example 2. To figure the amount to enter on line 3b, column (b)(iv): **(1)** divide the amount on line 3b, column (a)(ii) by the amount on line 2, column (a)(ii); and **(2)** multiply the result by the amount on line 2, column (b)(iv).

Column (c)

Complete this column to apportion all other deductions not definitely allocable (other than interest deductions and R&D deductions). See Regulations section 1.861-8 and Temporary Regulations sections 1.861-8T and 1.861-14T.

Line 1a. Enter the total other deductions. Examples include: stewardship expenses; legal and accounting expenses; and other expenses related to certain supportive functions such as overhead, general and

administrative, advertising, and marketing.

Lines 3a through 3k. Enter the amounts apportioned to each statutory grouping.

Schedules I and J

See the separate instructions for Schedule I and Schedule J to see if the corporation must file these schedules.

Foreign Country and U.S. Possession Codes

Enter the following codes in the appropriate columns as requested in Schedule A, Schedule C, Schedule D, and Schedule E.

| Country | Code | Country | Code |
|---------------------------------------|------|---|------|
| Abu Dhabi | TC | Croatia | HR |
| Afghanistan | AF | Cuba | CU |
| Albania | AL | Curaçao | NT |
| Algeria | AG | Cyprus | CY |
| American Samoa | AQ | Czech Republic | EZ |
| Andorra | AN | Denmark | DA |
| Angola | AO | Djibouti | DJ |
| Anguilla | AV | Dominica | DO |
| Antarctica | AY | Dominican Republic | DR |
| Antigua and Barbuda | AC | Dubai | TC |
| Argentina | AR | Ecuador | EC |
| Armenia | AM | Egypt | EG |
| Aruba | AA | Eleuthera Island | BF |
| Ashmore and Cartier Islands | AT | El Salvador | ES |
| Australia | AS | Equatorial Guinea | EK |
| Austria | AU | Eritrea | ER |
| Azerbaijan | AJ | Estonia | EN |
| Azores | PO | Ethiopia | ET |
| Bahamas, The | BF | Europa Island | EU |
| Bahrain | BA | Falkland Islands (Islas Malvinas) | FK |
| Baker Island | FQ | Faroe Islands | FO |
| Balearic Islands (Mallorca, etc.) | SP | Fiji | FJ |
| Bangladesh | BG | Finland | FI |
| Barbados | BB | France | FR |
| Bassas da India | BS | French Guiana | FG |
| Belarus | BO | French Polynesia (Tahiti) | FP |
| Belgium | BE | French Southern and Antarctic Lands | FS |
| Belize | BH | Gabon | GB |
| Benin (Dahomey) | BN | Gambia, The | GA |
| Bermuda | BD | Gaza Strip | GZ |
| Bhutan | BT | Georgia | GG |
| Bolivia | BL | Germany | GM |
| Bonaire | NT | Ghana | GH |
| Bosnia-Herzegovina | BK | Gibraltar | GI |
| Botswana | BC | Glorioso Islands | GO |
| Bouvet Island | BV | Great Britain (United Kingdom) | UK |
| Brazil | BR | Greece | GR |
| British Indian Ocean Territory | IO | Greenland | GL |
| Brunei | BX | Grenada (Southern Grenadines) | GJ |
| Bulgaria | BU | Guadeloupe | GP |
| Burkina Faso (Upper Volta) | UV | Guam | GQ |
| Burma | BM | Guatemala | GT |
| Burundi | BY | Guernsey | GK |
| Cambodia (Kampuchea) | CB | Guinea | GV |
| Cameroon | CM | Guinea-Bissau | PU |
| Canada | CA | Guyana | GY |
| Canary Islands | SP | Haiti | HA |
| Cape Verde | CV | Heard Island and McDonald Islands | HM |
| Cayman Islands | CJ | Honduras | HO |
| Central African Republic | CT | Hong Kong | HK |
| Chad | CD | Howland Island | HQ |
| Chile | CI | Hungary | HU |
| China, Peoples Republic of | CH | Iceland | IC |
| Christmas Island (Indian Ocean) | KT | India | IN |
| Clipperton Island | IP | Indonesia | ID |
| Cocos (Keeling) Islands | CK | Iran | IR |
| Colombia | CO | Iraq | IZ |
| Comoros | CN | Ireland | EI |
| Congo (Brazzaville) | CF | Isle of Man | IM |
| Congo, Democratic Republic of (Zaire) | CG | Israel | IS |
| Cook Islands | CW | Italy | IT |
| Coral Sea Islands Territory | CR | Jamaica | JM |
| Corsica | VP | Jan Mayen | JN |
| Costa Rica | CS | Japan | JA |
| Cote D' Ivoire (Ivory Coast) | IV | Jersey | JE |
| | | Johnston Atoll | JQ |
| | | Jordan | JO |
| | | Juan de Nova Island | JU |
| | | Kazakhstan | KZ |
| | | Kenya | KE |
| | | Kingman Reef | KQ |
| | | Kiribati (Gilbert Islands) | KR |
| | | Korea, Democratic People's Republic of (North) | KN |
| | | Korea, Republic of (South) | KS |
| | | Kurile Islands | RS |
| | | Kuwait | KU |
| | | Kyrgyzstan | KG |
| | | Laos | LA |
| | | Latvia | LG |
| | | Lebanon | LE |
| | | Lesotho | LT |
| | | Liberia | LI |
| | | Libya | LY |
| | | Liechtenstein | LS |
| | | Lithuania | LH |
| | | Luxembourg | LU |
| | | Macau | MC |
| | | Macedonia (former Yugoslav Republic of) | MK |
| | | Madagascar (Malagasy Republic) | MA |
| | | Malawi | MI |
| | | Malaysia | MY |
| | | Maldives | MV |
| | | Mali | ML |
| | | Malta | MT |
| | | Marshall Islands | RM |
| | | Martinique | MB |
| | | Mauritania | MR |
| | | Mauritius | MP |
| | | Mayotte | MF |
| | | Mexico | MX |
| | | Micronesia, Federated States of | FM |
| | | Midway Islands | MQ |
| | | Moldova | MD |
| | | Monaco | MN |
| | | Mongolia | MG |
| | | Montenegro | MW |
| | | Montserrat | MH |
| | | Morocco | MO |
| | | Mozambique | MZ |
| | | Namibia | WA |
| | | Nauru | NR |
| | | Navassa Island | BQ |
| | | Nepal | NP |
| | | Netherlands | NL |
| | | Netherlands Antilles | NT |
| | | New Caledonia | NC |
| | | New Zealand | NZ |
| | | Nicaragua | NU |
| | | Niger | NG |
| | | Nigeria | NI |
| | | Niue | NE |
| | | Norfolk Island | NF |
| | | Northern Ireland | UK |
| | | Northern Mariana Islands | CQ |
| | | Norway | NO |
| | | Oman | MU |
| | | Pakistan | PK |
| | | Palau | PS |
| | | Palmyra Atoll | LQ |
| | | Panama | PM |
| | | Papua New Guinea | PP |
| | | Paracel Islands | PF |
| | | Paraguay | PA |
| | | Peru | PE |
| | | Philippines | RP |
| | | Pitcairn Island | PC |
| | | Poland | PL |
| | | Portugal | PO |
| | | Puerto Rico | RQ |
| | | Qatar | QA |
| | | Redonda | VT |
| | | Reunion | RE |
| | | Romania | RO |
| | | Russia | RS |
| | | Rwanda | RW |
| | | Ryukyu Islands | JA |
| | | St. Helena (Ascension Island and Tristan de Cunha Island Group) | SH |
| | | St. Kitts (St. Christopher and Nevis) | SC |

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|--|----|
| St. Lucia..... | ST |
| St. Pierre and Miquelon..... | SB |
| St. Vincent and the Grenadines (Northern Grenadines)..... | VC |
| San Marino..... | SM |
| Sao Tome and Principe..... | TP |
| Sarawak..... | MY |
| Saudi Arabia..... | SA |
| Senegal..... | SG |
| Serbia..... | SR |
| Seychelles..... | SE |
| Sierra Leone..... | SL |
| Singapore..... | SN |
| Slovakia..... | LO |
| Slovenia..... | SI |
| Solomon Islands..... | BP |
| Somalia..... | SO |
| South Africa..... | SF |
| South Georgia and the South Sandwich Islands..... | SX |
| Spain..... | SP |
| Spratly Islands..... | PG |
| Sri Lanka..... | CE |
| Sudan..... | SU |
| Suriname..... | NS |
| Svalbard (Spitsbergen)..... | SV |
| Swaziland..... | WZ |
| Sweden..... | SW |
| Switzerland..... | SZ |
| Syria..... | SY |
| Taiwan..... | TW |
| Tajikistan..... | TI |
| Tanzania, United Republic of..... | TZ |
| Thailand..... | TH |
| Togo..... | TO |
| Tokelau..... | TL |
| Tonga..... | TN |
| Tortola..... | VI |
| Trinidad and Tobago..... | TD |
| Tromelin Island..... | TE |
| Tunisia..... | TS |
| Turkey..... | TU |
| Turkmenistan..... | TX |
| Turks and Caicos Islands..... | TK |
| Tuvalu..... | TV |
| Uganda..... | UG |
| Ukraine..... | UP |
| United Arab Emirates..... | TC |
| United Kingdom (England, Wales, Scotland, No. Ireland)..... | UK |
| Uruguay..... | UY |
| Uzbekistan..... | UZ |
| Vanuatu..... | NH |
| Vatican City..... | VT |
| Venezuela..... | VE |
| Vietnam..... | VM |
| Virgin Islands (British)..... | VI |
| Virgin Islands (U.S.)..... | VQ |
| Wake Island..... | WQ |
| Wallis and Futuna..... | WF |
| West Bank..... | WE |
| Western Sahara..... | WI |
| Western Samoa..... | WS |
| Yemen (Aden)..... | YM |
| Zaire (Democratic Republic of Congo)..... | CG |
| Zambia..... | ZA |
| Zimbabwe..... | ZI |
| Other Countries..... | OC |