

Internal Revenue Service, Treasury

§ 1.904(b)-2

Foreign business income + Foreign source capital gain net income - 18/46 (foreign source net capital gain) - (paragraph

(a)(3)(i) adjustment - paragraph (a)(3)(ii) adjustment)

$$\$2,000,000 + 0 - 0 - \$500,000 + \frac{18}{46} \frac{(\$100,000)}{(\$39,130)} = \$1,539,130$$

(i) The entire taxable income is determined as follows:

Business income + Capital gain net income - 18/46 (net capital gain)
 \$4,500,000 + 0 - 0 = \$4,500,000

Note that no adjustment under paragraph (a)(3) of this section is made with respect to the denominator.

[T.D. 7914, 48 FR 44520, Sept. 29, 1983]

§ 1.904(b)-2 Treatment of capital gains for other taxpayers.

(a) *In general.* For purposes of computing the foreign tax credit limitation of persons other than corporations, the following rules apply:

(1) *Inclusion in foreign source taxable income.* The taxable income from sources without the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income (as defined in paragraph (b)(2) of §1.904(b)-1), reduced by an amount determined by multiplying foreign source net capital gain (as defined in paragraph (b)(4) of §1.904(b)-1) by the percentage specified under section 1202(a).

(2) *Inclusion in entire taxable income.* The entire taxable income of a taxpayer other than a corporation shall include gains from the sale or exchange of capital assets only to the extent of capital gain net income (as defined in paragraph (b)(1) of §1.904(b)-1), reduced by an amount determined by multiplying net capital gain (as defined in paragraph (b)(3) of §1.904(b)-1) by the percentage specified under section 1202(a).

(3) *Treatment of capital losses.* The taxable income from sources without the United States shall be reduced by:

(i) Any net capital loss (as defined in paragraph (b) of this section) allocable or apportionable to sources without the United States to the extent taken

into account in determining capital gain net income, less

(ii) An amount equal to the excess of net capital gain from sources within the United States over net capital gain, multiplied by the percentage specified under section 1202(a).

(b) *Definition of net capital loss.* For purposes of paragraph (a) of this section, the term *net capital loss* means the excess of the losses from the sale or exchange of capital assets treated as capital losses under the Internal Revenue Code and any carryforward as determined under section 1212 over the amount allowed under section 1211(b). In determining net capital loss, gains and losses which are not from the sale or exchange of capital assets but which are treated as capital gains and losses under the Internal Revenue Code are included.

(c) *Illustrations.* The principles of paragraph (a) of this section are illustrated by the following examples:

Example 1. X, an individual, has \$1,500,000 of foreign source taxable income and \$2,500,000 of U.S. source taxable income (exclusive of capital gains and losses) for 1979 and the following capital gains and losses:

	In thousands		
	Foreign source	U.S. source	All sources
Long-term capital gain	\$300	\$500	\$800
Long-term capital loss	100	500	600
Short-term capital gain	100	400	500
Short-term capital loss	100	200	300

For purposes of computing the foreign tax credit limitation, the foreign source taxable income and the entire taxable income of X are computed as follows:

Step (1) First, compute the net long-term capital gain and net short-term capital gain and the net long-term capital loss and net short-term capital loss allocable or apportionable to such sources, from sources without the United States and from all sources, as follows:

§ 1.904(b)-2

26 CFR Ch. I (4-1-01 Edition)

	In thousands	
	Sources without the U.S.	All sources
Net long-term capital gain	\$200	\$200
Net long-term capital loss	0	0
Net short-term capital gain	0	200
Net short-term capital loss	0	0

Step (2) Next compute capital gain net income and net capital gain from sources without United States and from all sources as follows:

	In thousands	
	Sources without the U.S.	All sources
Capital gain net income	(a) \$200	(b) \$400
Net capital gain	(c) 200	(d) 200

Step (3) Next calculate foreign source capital gain net income and foreign source net capital gain, which is the lesser (a) or (b) and the lesser of (c) or (d), respectively. Foreign source capital gain net income is \$200,000 and foreign source net capital gain is \$200,000.

Step (4) Compute taxable income from sources without the United States, using 0.60 as the percentage specified in section 1202(a), as follows:

Foreign taxable income (exclusive of capital gains and losses)+Foreign source capital gain net income - 0.60 (foreign source net capital gain)
 $\$1,500,000 + \$200,000 - 0.60(\$200,000) = \$1,580,000$

Step (5) Compute the entire taxable income as follows:

Taxable income (exclusive of capital gains and losses)+Capital gain net income - 0.60 (net capital gain)
 $\$4,000,000 + \$400,000 - 0.60 (\$200,000) (\$120,000) = \$4,280,000$

Example 2. Y, an individual, has \$2,000,000 of foreign source taxable income and \$3,000,000 of U.S. source taxable income (exclusive of capital gains and losses) for 1979 and the following capital gains and losses:

	In thousands		
	Foreign source	U.S. source	All sources
Long-term capital gain	\$200	\$800	\$1,000
Long-term capital loss	700	100	800
Short-term capital gain	100	300	400
Short-term capital loss	300	200	500

For purposes of computing the foreign tax credit limitation, the foreign source taxable income and the entire taxable income of Y are computed as follows:

Step (1) First, compute the net long-term capital gain and net short-term capital gain and the net long-term capital loss and net

short-term capital loss allocable or apportionable to such sources, from sources without the United States and from all sources, as follows:

	In thousands	
	Sources without the United States	All sources
Net long-term capital gain	0	\$200
Net long-term capital loss	\$500	0
Net short-term capital gain	0	0
Net short-term capital loss	200	100

Step (2) Next compute the capital gain net income and net capital gain from sources without the United States and from all sources as follows:

	In thousands	
	Sources without the United States	All sources
Capital gain net income	(a) 0	(b) \$100
Net capital gain	(c) 0	(d) 100

Step (3) Next calculate foreign source capital gain net income and foreign source net capital gain, which is the lesser of (a) or (b) and the lesser of (c) or (d), respectively. Foreign source capital gain net income is zero and foreign source net capital gain is also zero.

Step (4) Under paragraph (a)(3)(i) of this section, the taxable income from sources without the United States is reduced by the amount by which the net capital loss allocable or apportionable to sources without the United States reduces capital gains (long and short-term) from sources within the United States when computing capital gain net income. This is determined by first computing the net capital loss allocable or apportionable to sources without the United States (\$700,000) and the capital gain net income from sources within the United States (\$800,000). In this case, \$700,000 of net capital loss allocable or apportionable to sources without the United States reduces \$700,000 of long and short-term capital gain in computing capital gain net income.

Step (5) Under paragraph (a)(3)(ii) of this section, the adjustment under paragraph (a)(3)(i) of this section is reduced by an amount equal to the difference between net capital gain from sources within the United States and net capital gain (from all sources), multiplied by the percentage specified under section 1202(a). In this case, the net capital gain from sources within the United States is \$700,000 the net capital gain is \$100,000 and the percentage specified under section 1202(a) is 0.60.

Internal Revenue Service, Treasury

§ 1.904(b)-3

Step (6) Computation of foreign tax credit limitation fraction.

(i) Taxable income from sources without the United States is as follows:

Foreign income (exclusive of capital gains and losses)+Foreign source capital gain net income -0.60 (foreign source net capital gain)-(paragraph (a)(3)(i) adjustment - paragraph (a)(3)(ii) adjustment)

$$\$2,000,000 + 0 - 0 - \$700,000 + 0.60 (\$600,000) (\$360,000) = \$1,660,000$$

(ii) The entire taxable income is as follows:

Taxable income (exclusive of capital gains and losses)+Capital gains net income -0.60(net capital gain)

$$\$5,000,000 + \$100,000 - \$60,000 = \$5,040,000$$

Note that no adjustment under paragraph (a)(3) of this section is made with respect to the denominator.

[T.D. 7914, 48 FR 44523, Sept. 29, 1983]

§ 1.904(b)-3 Sale of personal property.

(a) *General rule.* For purposes of section 904 and the regulations thereunder, there shall be included as gain from sources within the United States any gain from sources without the United States arising from the sale or exchange of a capital asset which is personal property (as defined in §1.1245-3(b)). For purposes of this paragraph, gain from the sale or exchange of a capital asset shall include net section 1231 gain, but shall not include gain from the sale or exchange of a capital asset which is not treated as capital gain. However, gains and losses which are not from the sale or exchange of capital assets but which are treated as capital gains and losses under the Internal Revenue Code are included. The special source rules provided under this section shall be applied on an item by item basis with respect to the sale of personal property within any taxable year, except that if substantially all the assets of a trade or business (within the meaning of section 368(a)(1)(C) are sold within any one country within any taxable year, the gains and losses from such sales of such assets shall be netted before applying the source rules under this section.

(b) *Special rules.* Paragraph (a) of this section shall not apply in each of the following cases:

(1) In the case of an individual, if the property is sold or exchanged within

the country or possession of the individual's residence.

(2) In the case of a corporation if the property is stock in a second corporation, and is sold in a country or possession in which the second corporation derived more than 50 percent of its gross income for the 3-year period ending with the close of such second corporation's taxable year immediately preceding the year during which the sale or exchange occurred (or for such part of such period as the corporation has been in existence, but in no event less than a 12-month period). For purposes of this paragraph (b)(2) of this section the gross income of any foreign corporation shall be computed in the same manner as if the foreign corporation were a domestic corporation. Thus, the gross income of a foreign corporation for this purpose includes income from all sources, which is not specifically excluded from gross income under any other provisions of the Code.

(3) In the case of any taxpayer, if the property is personal property (other than stock in a corporation) which is sold or exchanged in a country or possession in which the property is used in a trade or business of the taxpayer, or in which the taxpayer derived more than 50 percent of its gross income for the 3-year period ending with the close of its taxable year immediately preceding the year during which the sale or exchange occurred (or, in case of a taxpayer other than an individual, for such part of such period as the taxpayer has been in existence, but in no event less than a 12-month period). In the case of property sold or exchanged by a partnership, trust, or estate, the determination required by the preceding sentence shall be made at the level of the partnership, trust (other than a grantor trust), or estate. For purposes of this paragraph (b)(3) of this