

Internal Revenue Service, Treasury

§ 1.904(b)-2

apportionate to such sources, from sources without the United States and from all sources, as follows:

	In thousands	
	Sources without the U.S.	All sources
Net long-term capital gain	0	100
Net long-term capital loss	0	0
Net short-term capital gain	0	0
Net short-term capital loss	500	100

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

	In thousands	
	Sources without the U.S.	All sources
Capital gain net income	(a) 0	(b) 0
Net capital gain	(c) 0	(d) 0

Step (3) Next compute 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 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 (\$500,000), and the capital gain net income from sources within the United States (\$500,000). In this case, \$500,000 of net capital loss allocable or apportionable to sources without the United States reduces \$500,000 of net long- and short-term gains from sources within the United States 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 rate differential portion of net capital gain from sources within the United States over net capital gain (from all sources). In this case, net capital gain from sources within the United States is \$100,000 and the net capital gain is zero, so an amount equal to $\frac{18}{46}$ multiplied by \$100,000 is added to the numerator of the foreign tax credit limitation fraction in computing taxable income from sources without the United States.

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

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

$$\text{Foreign business income} + \text{Foreign source capital gain net income} - \frac{18}{46} (\text{foreign source net capital gain}) - (\text{paragraph (a)(3)(i) adjustment} - \text{paragraph (a)(3)(ii) adjustment})$$

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

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

$$\begin{aligned} &\text{Business income} + \text{Capital gain net income} \\ &\quad - \frac{18}{46} (\text{net capital gain}) \\ & \$4,500,000 + 0 - 0 = \$4,500,000 \end{aligned}$$

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

§ 1.904(b)-2

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:

	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:

Internal Revenue Service, Treasury

§ 1.904(b)-3

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.

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