

Internal Revenue Service, Treasury

§ 1.904-3

taxable years, the unused foreign tax deemed accrued under section 904(d) in the appropriate taxable years is as follows:

	Per country	Overall	Overall	Overall	Overall	Per country
Taxable years	1961	1962	1963	1964	1965	1966
Limitation:						
Country X	\$175	.....	.....	.....	.....	\$290
Country Y	125	.....	.....	.....	.....	95
Overall .....	.....	\$250	\$800	\$300	\$400	.....
Taxes actually accrued:						
Country X	325	.....	.....	.....	.....	200
Country Y	85	.....	.....	.....	.....	100
Aggregate .....	.....	350	380	425	450	.....
Unused foreign tax to be carried back or over from year of origin:						
Country X	150	.....	.....	.....	.....	.....
Country Y .....	.....	.....	.....	.....	.....	5
Aggregate .....	.....	100	.....	125	50	.....
Excess limitation:						
Country X .....	.....	.....	.....	.....	.....	90
Country Y	40	.....	.....	.....	.....	.....
Overall .....	.....	.....	420	.....	.....	.....
Unused foreign tax absorbed as taxes deemed accrued under section 904(d) and carried from—						
1961 (Country X) .....	.....	.....	.....	.....	.....	(90)
1962 (Overall) .....	.....	.....	(100)	.....	.....	.....
1964 (Overall) .....	.....	.....	(125)	.....	.....	.....
1965 (Overall) .....	.....	.....	(50)	.....	.....	.....

(ii) Since the per-country limitation is applicable for 1961 and 1966 only, any unused foreign tax with respect to such years may not be deemed accrued in 1962, 1963, 1964, or 1965, years for which the overall limitation applies. However, the excess limitation for 1966 with respect to country X (\$90) is available to absorb a part of the unused foreign tax for 1961 with respect to country X. The difference with respect to country X between the unused foreign tax for 1961 (\$150) and the amount absorbed as taxes deemed accrued (\$90) in 1966, or \$60, may not be carried beyond 1966 since the unused foreign tax may be carried forward only 5 taxable years. There is no excess limitation with respect to country Y for 1961 in respect of the unused foreign tax of country Y for 1966, since the unused foreign tax may be carried back only 2 taxable years.

(iii) Since the overall limitation is applicable for 1962, 1963, 1964, and 1965, any unused foreign tax with respect to such years may not be absorbed as taxes deemed accrued in 1961 or 1966, years for which the per-country limitation applies. However, the excess limitation for 1963 (\$420) computed on the basis of the overall limitation is available to absorb the unused foreign tax for 1962 (\$100), the unused foreign tax for 1964 (\$125), and the unused foreign tax for 1965 (\$50), leaving an

excess limitation above such absorption of \$145 (\$420-\$275).

[T.D. 6789, 29 FR 19244, Dec. 31, 1964, as amended by T.D. 7294, 38 FR 33081, Nov. 30, 1973; T.D. 7292, 38 FR 33292, Dec. 3, 1973; T.D. 7490, 42 FR 30497, June 15, 1977; T.D. 7961, 49 FR 26225, June 27, 1984; 49 FR 29594, July 23, 1984]

§ 1.904-3 Carryback and carryover of unused foreign tax by husband and wife.

(a) *In General.* This section provides rules, in addition to those prescribed in §1.904-2, for the carryback and carryover of the unused foreign tax paid or accrued to a foreign country or possession by a husband and wife making a joint return for one or more of the taxable years involved in the computation of the carryback or carryover.

(b) *Joint unused foreign tax and joint excess limitation.* In the case of a husband and wife the joint unused foreign tax or the joint excess limitation for a taxable year for which a joint return is made shall be computed on the basis of the combined income, deductions, taxes, and credit of both spouses as if

the combined income, deductions, taxes, and credit were those of one individual.

(c) *Continuous use of joint return.* If a husband and wife make a joint return for the current taxable year, and also make joint returns for each of the other taxable years involved in the computation of the carryback or carryover of the unused foreign tax to the current taxable year, the joint carryback or the joint carryover to the current taxable year shall be computed on the basis of the joint unused foreign tax and the joint excess limitations.

(d) *From separate to joint return.* If a husband and wife make a joint return for the current taxable year, but make separate returns for all of the other taxable years involved in the computation of the carryback or carryover of the unused foreign tax to the current taxable year, the separate carrybacks or separate carryovers shall be a joint carryback or a joint carryover to the current taxable year. If for such current year the per-country limitation applies, then only the unused foreign tax for a taxable year of a spouse for which the per-country limitation applied to such spouse may constitute a carryover or carryback to the current taxable year. If for such current taxable year the overall limitation applies, then only the unused foreign tax for a taxable year of a spouse for which the overall limitation applied to such spouse may constitute a carryover or carryback to the current taxable year.

(e) *Amounts carried from or through a joint return year to or through a separate return year.* It is necessary to allocate to each spouse his share of an unused foreign tax or excess limitation for any taxable year for which the spouses filed a joint return if—

(1) The husband and wife file separate returns for the current taxable year and an unused foreign tax is carried thereto from a taxable year for which they filed a joint return;

(2) The husband and wife file separate returns for the current taxable year and an unused foreign tax is carried to such taxable year from a year for which they filed separate returns but is first carried through a year for which they filed a joint return; or

(3) The husband and wife file a joint return for the current taxable year and an unused foreign tax is carried from a taxable year for which they filed joint returns but is first carried through a year for which they filed separate returns.

In such cases, the separate carryback or carryover of each spouse to the current taxable year shall be computed in the manner described in § 1.904-2 but with the modifications set forth in paragraph (f) of this section. Where applicable, appropriate adjustments shall be made to take into account the fact that, for any taxable year involved in the computation of the carryback or the carryover, either spouse has interest income described in section 904(f)(2) with respect to which the provisions of section 904(f) and § 1.904-4 apply, or dividends described in section 904(f)(1)(B) with respect to which the provisions of section 904(f) and § 1.904-5 apply, or foreign oil related income described in section 907(c) with respect to which the separate limitation in section 907(b) applies.

(f) *Allocation of unused foreign tax and excess limitation—(1) Limitation—(i) Per-country limitation.* The per-country limitation of a particular spouse with respect to a foreign country or United States possession for a taxable year for which a joint return is made shall be the portion of the limitation on the joint return which bears the same ratio to such limitation as such spouse's taxable income (with gross income and deductions taken into account to the same extent as taken into account on the joint return) from sources within such country or possession (but not in excess of the joint taxable income from sources within such country or possession) bears to the joint taxable income from such sources.

(ii) *Overall limitation.* The overall limitation of a particular spouse for a taxable year for which a joint return is made shall be the portion of the limitation on the joint return which bears the same ratio to such limitation as such spouse's taxable income (with gross income and deductions taken into account to the same extent as taken into account on the joint return) from sources without the United States (but not in excess of the joint taxable

income from such sources) bears to the joint taxable income from such sources.

(2) *Unused foreign tax*—(i) *Per-country limitation*. The unused foreign tax of a particular spouse with respect to a foreign country or United States possession for a taxable year for which a joint return is made shall be the excess of his tax paid or accrued to such country or possession over his limitation determined under subparagraph (1)(i) of this paragraph.

(ii) *Overall limitation*. The unused foreign tax of a particular spouse for a taxable year to which the overall limitation applies and for which a joint return is made shall be the excess of his tax paid or accrued to foreign countries and United States possessions over his limitation determined under subparagraph (1)(ii) of this paragraph.

(3) *Excess limitation*—(i) *Per-country limitation taxpayer*. A spouse's excess limitation with respect to a foreign country or possession for a taxable year for which a joint return is made shall be the excess of his limitation determined under subparagraph (1)(i) of this paragraph over his taxes paid or accrued to such country or possession for such taxable year.

(ii) *Overall limitation*. A spouse's excess limitation for a taxable year to which the overall limitation applies and for which a joint return is made shall be the excess of his limitation determined under subparagraph (1)(ii) of this paragraph over his taxes paid or accrued to foreign countries and United States possessions for such taxable year.

(4) *Excess limitation to be applied*. The excess limitation of the particular spouse for any taxable year which is applied against the unused foreign tax of that spouse for another taxable year in order to determine the amount of the unused foreign tax which shall be carried back or over to a third taxable year shall be, in a case in which the excess limitation is determined on a joint return, the sum of the following amounts:

(i) Such spouse's excess limitation determined under subparagraph (3) of this paragraph reduced as provided in subparagraph (5)(i) of this paragraph, and

(ii) The excess limitation of the other spouse determined under subparagraph (3) of this paragraph for that taxable year reduced as provided in subparagraphs (5) (i) and (ii) of this paragraph.

(5) *Reduction of excess limitation*. (i) The part of the excess limitation which is attributable to each spouse for the taxable year, as determined under subparagraph (3) of this paragraph, shall be reduced by absorbing as taxes deemed paid or accrued under section 904(d) in that year the unabsorbed separate unused foreign tax of such spouse, and the unabsorbed unused foreign tax determined under subparagraph (2) of this paragraph of such spouse, for taxable years which begin before the beginning of the year of origin of the unused foreign tax of the particular spouse against which the excess limitation so determined is being applied.

(ii) In addition, the part of the excess limitation which is attributable to the other spouse for the taxable year, as determined under subparagraph (3) of this paragraph, shall be reduced by absorbing as taxes deemed paid or accrued under section 904(d) in that year the unabsorbed unused foreign tax, if any, of such other spouse for the taxable year which begins on the same date as the beginning of the year of origin of the unused foreign tax of the particular spouse against which the excess limitation so determined is being applied.

(6) *Spouses using different limitations*. If an unused foreign tax is carried through a taxable year for which spouses made a joint return and the credit under section 901 for such taxable year is not claimed, and in the prior taxable year separate returns are made in which the per-country limitation applies to one spouse and the overall limitation applies to the other spouse, the amount treated as absorbed in the taxable year for which a joint return is made—

(i) With respect to the spouse for which the per-country limitation applies shall be determined on the basis of the excess limitation which would be allocated to such spouse under subparagraph (3)(i) of this paragraph had the per-country limitation applied for such year to both spouses;

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(ii) With respect to the other spouse for which the overall limitation applies shall be determined on the basis of the excess limitation which would be allocated to such spouse under subparagraph (3)(ii) of this paragraph had the overall limitation applied for such year to both spouses.

This subparagraph shall be applied without regard to subparagraph (4)(ii) of this paragraph.

(g) *Illustrations.* This section may be illustrated by the following examples:

Example 1. (a) H and W, calendar year taxpayers, file joint returns for 1961 and 1963,

and separate returns for 1962, 1964, and 1965; and for each of those taxable years they choose to claim a credit under section 901. For the taxable years involved, they had unused foreign tax, excess limitations, and carrybacks and carryovers of unused foreign tax as set forth below. The overall limitation applies to both spouses for all taxable years involved in this example. Neither H nor W had an unused foreign tax or excess limitation for any year before 1961 or after 1965. For purposes of this example, any reference to an excess limitation means such a limitation as determined under paragraph (c)(2)(ii) of § 1.904-2 but without regard to any taxes deemed paid or accrued under section 904(d):

	Taxable year				
	1961	1962	1963	1964	1965
Return	Joint	Separate	Joint	Separate	Separate
H's unused foreign tax to be carried over or back, or excess limitation (enclosed in parentheses)	\$500	\$250	(\$650)	\$400	(\$500)
W's unused foreign tax to be carried over or back, or excess limitation (enclosed in parentheses)	300	(200)	(300)	150	(100)
Total	800		(950)		
Carryovers absorbed:					
W's, from 1961		¹ 200W	100W		
H's, from 1961			² 500H		
H's, from 1962			150H		
W's, from 1964			100W		50W
H's, from 1964					400H
Carrybacks absorbed:					
W's, from 1964		0	100W		
H's, from 1964			0		

¹ W—absorbed by W's excess limitation.
² H—absorbed by H's excess limitation.

(b) Two hundred dollars of the \$300 constituting W's part of the joint unused foreign tax for 1961 is absorbed by her separate excess limitation of \$200 for 1962, and the remaining \$100 of such part is absorbed by her part (\$300) of the joint excess limitation for 1963. The excess limitation of \$300 for 1963 is not required first to be reduced by any amount, since neither H nor W has any unused foreign tax for taxable years beginning before 1961.

(c) H's part (\$500) of the joint unused foreign tax for 1961 is absorbed by his part (\$650) of the joint excess limitation for 1963. The excess limitation of \$650 for 1963 is not required first to be reduced by any amount, since neither H nor W has any unused foreign tax for taxable years beginning before 1961.

(d) H's unused foreign tax of \$250 for 1962 is first absorbed (to the extent of \$150) by H's part of the joint excess limitation for 1963, which must first be reduced from \$650 to \$150 by the absorption as taxes deemed paid or accrued in 1963 of H's unused foreign tax of

\$500 for 1961, which is a taxable year beginning before 1962. The remaining part (\$100) of H's unused foreign tax for 1962 is then absorbed by W's part of the joint excess limitation for 1963, which must first be reduced from \$300 to \$200 by the absorption as taxes deemed paid or accrued in 1963 of the unabsorbed part \$100 of W's unused foreign tax for 1961, which is a taxable year beginning before 1962.

(e) W's unused foreign tax of \$150 for 1964 is first absorbed (to the extent of \$100) by W's part of the joint excess limitation for 1963, which must first be reduced from \$300 to \$100 by the absorption as taxes deemed paid or accrued in 1963 of the unabsorbed part (\$100) of W's unused foreign tax for 1961 and the unabsorbed part (\$100) of H's unused foreign tax for 1962, which are taxable years beginning before 1964. No part of W's unused foreign tax for 1964 is absorbed by H's part of the joint excess limitation for 1963, since H's part of that excess must first be reduced from \$650 to \$0 by the absorption as taxes

deemed paid or accrued in 1963 of H's unused foreign tax of \$500 for 1961 and of the unabsorbed part (\$150) of H's unused foreign tax for 1962, which are taxable years beginning before 1964. The unabsorbed part (\$50) of W's unused foreign tax for 1964 is then absorbed by W's excess limitation of \$100 for 1965. No part of W's unused foreign tax for 1964 is absorbed by W's excess limitation for 1962, since that excess limitation must first be reduced from \$200 to \$0 by W's unused foreign tax for 1961, which is a taxable year beginning before 1964.

(f) No part of H's unused foreign tax of \$400 for 1964 is absorbed by H's part of the joint excess limitation for 1963, since H's part of that excess must first be reduced from \$650 to \$0 by the absorption as taxes deemed paid or accrued in 1963 of H's unused foreign tax of \$500 for 1961 and of a part (\$150) of H's unused foreign tax for 1962, which are taxable years beginning before 1964. Moreover, no part of H's unused foreign tax of \$400 for 1964 is absorbed by W's part of the joint excess limitation for 1963, since W's part of that excess must first be reduced from \$300 to \$0 by the absorption as taxes deemed paid or accrued in 1963 of the unabsorbed part (\$100) of W's unused foreign tax for 1961 and of the unabsorbed part (\$100) of H's unused foreign tax for 1962, which are taxable years beginning before 1964, and also by the absorption of a part (\$100) of W's unused foreign tax of \$150 for 1964, which is a taxable year beginning on the same date as the beginning of H's taxable year 1964. The unabsorbed part (\$400) of H's unused foreign tax for 1964 is then absorbed by H's excess limitation of \$500 for 1965.

Example 2. (a) Assume the same facts as those in example 1 except that for 1964 W's unused foreign tax is \$20, instead of \$150. The carrybacks and carryovers absorbed are the same as in example 1 except as indicated in paragraphs (b) and (c) of this example.

(b) No part of W's unused foreign tax of \$20 for 1964 is absorbed by W's excess limitation for 1962, since that excess must first be reduced from \$200 to \$0 by W's unused foreign tax for 1961, which is a taxable year beginning before 1964. W's unused foreign tax of \$20 for 1964 is absorbed by W's part of the joint excess limitation for 1963, which must first be reduced from \$300 to \$100 by the absorption as taxes deemed paid or accrued in 1963 of the unabsorbed part (\$100) of W's unused foreign tax for 1961 and the unabsorbed part (\$100) of H's unused foreign tax for 1962, which are taxable years beginning before 1964.

(c) For the reason given in paragraph (f) of example 1, no part of H's unused foreign tax of \$400 for 1964 is absorbed by H's part of the joint excess limitation for 1963. H's unused foreign tax of \$400 for 1964 is first absorbed (to the extent of \$80) by W's part of the joint excess limitation for 1963, which must first

be reduced from \$300 to \$80 by the absorption as taxes deemed paid or accrued in 1963 of the unabsorbed part (\$100) of W's unused foreign tax for 1961 and of the unabsorbed part (\$100) of H's unused foreign tax for 1962, which are taxable years beginning before 1964, and also by the absorption of W's unused foreign tax of \$20 for 1964, which is a taxable year beginning on the same date as the beginning of H's taxable year 1964. The unabsorbed part (\$320) of H's unused foreign tax for 1964 is then absorbed by H's excess limitation of \$500 for 1965.

Example 3. The facts are the same as in example 1 except that the per-country limitation applies to both spouses for all taxable years involved in the example and that excess limitations and the unused foreign taxes relate to a single foreign country. The carryovers and carrybacks are the same as in example 1.

[T.D. 6789, 29 FR 19246, Dec. 31, 1964, as amended by T.D. 7292, 38 FR 33292, Dec. 3, 1973; T.D. 7490, 42 FR 30497, June 15, 1977; T.D. 7961, 49 FR 26225, June 27, 1984]

§ 1.904-4 Separate application of section 904 with respect to certain categories of income.

(a) *In general.* A taxpayer is required to compute a separate foreign tax credit limitation for income received or accrued in a taxable year that is described in section 904(d)(1)(A) (passive income), (B) (high withholding tax interest), (C) (financial services income), (D) (shipping income), (E) (dividends from each noncontrolled section 902 corporation), (F) (dividends from a DISC or former DISC), (G) (foreign trade income), (H) (distributions from a FSC or former FSC), or (I) (general limitation income).

(b) *Passive income*—(1) *In general*—(i) *Rule.* The term “passive income” means any—

(A) Income received or accrued by any person that is of a kind that would be foreign personal holding company income (as defined in section 954(c)) if the taxpayer were a controlled foreign corporation, including any amount of gain on the sale or exchange of stock in excess of the amount treated as a dividend under section 1248; or

(B) Amount includible in gross income under section 551 or section 1293. Passive income does not include any income that is also described in section 904(d)(1)(B) through (H), any export financing interest (as defined in section 904(d)(2)(G) and paragraph (h) of this