

[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9595]

RIN 1545-BH13

Treatment of Overall Foreign and Domestic Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations with respect to a provision of the Internal Revenue Code (Code) relating to the recapture of overall domestic losses that was enacted as part of the American Jobs Creation Act of 2004 (AJCA). These regulations provide guidance regarding these changes, as well as updated guidance with respect to overall foreign losses and separate limitation losses, and affect individuals and corporations claiming foreign tax credits.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §§1.904(f)-1(g), 1.904(f)-2(e), 1.904(f)-7(f), 1.904(f)-8(c), 1.904(g)-1(f), 1.904(g)-2(d), 1.904(g)-3(k), and 1.1502-9(e).

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Parry, (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 21, 2007, a notice of proposed rulemaking by cross-reference to temporary regulations (REG-141399-07) under section 904 of the Code and temporary regulations (TD 9371) (2007 temporary regulations) were published in the **Federal Register** at 72 FR 72645 and 72 FR 72592, respectively. No written comments were received. A public hearing was not requested and none was held. This Treasury decision adopts the proposed regulation with the changes discussed in this preamble.

Explanation of Changes

I. Dispositions of Property under Section 904(f)(3)

Section 904(f)(3) provides that if a taxpayer disposes of certain property used or held for use predominantly without the United States in a trade or business, gain is recognized on that disposition and treated as foreign source income, regardless of whether the gain would otherwise be recognized, to the extent of any overall foreign loss account in the separate category of foreign source taxable income generated by the property. Section 1.904(f)-2(d) provides separate rules for dispositions in which gain is recognized irrespective of section 904(f)(3) and dispositions in which the gain would not otherwise be recognized.

A question has arisen regarding dispositions in which gain is recognized irrespective of section 904(f)(3) and the recognized gain is otherwise treated as U.S. source income under the Code. The Treasury Department and the IRS believe that the language of section 904(f)(3)(A) is clear that gain on such dispositions is recharacterized as foreign source income only to the extent of the applicable section 904(f)(3) recapture amount. Consistent with the statutory language, the regulations clarify that this limit on recharacterization applies. The amount of gain recharacterized

as foreign source is equal to the lesser of the total recognized gain or the balance in the overall foreign loss account remaining after any other overall foreign loss recapture pursuant to section 904(f)(1) has been made.

II. Adjustments for capital gains and losses and qualified dividend income

The 2007 temporary regulations provide rules coordinating the application of section 904(b), which addresses the effect of capital gains and losses on the foreign tax credit limitation, and section 904(g), which addresses overall domestic losses and the recapture of such losses. Section 1.904(g)-1T(c)(2), which defines the term domestic loss, provides that if a taxpayer has any capital gains or losses, the amount of the domestic loss is determined by taking into account adjustments under section 904(b)(2) and §1.904(b)-1. If the taxpayer has capital gains or losses, §1.904(g)-1T(d)(3) provides that the amount by which an overall domestic loss reduces foreign source income in a taxable year is determined in accordance with §1.904(b)-1(h)(1)(i) and (h)(1)(iii).

The 2007 temporary regulations followed the approach of the coordination rules in §1.904(b)-1(h), which generally provide that adjustments under section 904(b) to capital gains and losses and qualified dividend income (section 904(b) adjustments) are taken into account first before applying the overall foreign loss provisions of section 904(f). These final regulations retain that basic approach; however, they revise several provisions of the 2007 temporary regulations and add new provisions to implement the mechanics of this coordination rule.

First, §1.904(g)-1(c)(2) and (d)(3) are revised regarding the calculation of an overall domestic loss. These revisions reflect the fact that the regulations under section

904(b) do not provide specific adjustments to determine U.S. source loss on a stand-alone basis, but rather define the amount of U.S. source loss that offsets foreign source taxable income under section 904(f)(5)(D) as adjusted foreign taxable income, less adjusted worldwide taxable income. The calculation of the overall domestic loss is therefore expressly coordinated with the calculation of the section 904(f)(5)(D) amount as determined under §1.904(b)-1(h)(1)(iii).

Second, §1.904(g)-2(b) is revised to clarify that section 904(b) adjustments must be made for capital gains and losses and qualified dividend income before determining how much U.S. source taxable income is available to recapture an overall domestic loss account. Because the regulations under section 904(b) do not provide specific adjustments to determine U.S. source taxable income on a stand-alone basis, §1.904(g)-2(b) provides that U.S. source taxable income available to recapture an overall domestic loss account is determined following the principles of §1.904(b)-1(h)(1)(i), which provides rules on making the section 904(b) adjustments in determining foreign source taxable income.

Third, a new step is added to the ordering rules in §1.904(g)-3 to provide that any section 904(b) adjustments for capital gains and losses and qualified dividend income are made after determining the amount of net operating loss carryover, if any, in Step One, but before allocating losses or recapturing loss accounts in steps 3 through 7.

Finally, the regulations have been revised to clarify that coordination with the section 904(b) provisions requires adjustments not only to capital gains and losses but to qualified dividend income as well.

III. Miscellaneous revisions

Other revisions have been made to the 2007 temporary regulations that have no intended substantive effect beyond improving the readability of the provisions. These include clarifying the term “section 904(f)(1) recapture amount” in §1.904(f)-2)(c)(1) and simplifying the definitions of “separate limitation loss” and “separate limitation loss account” in §1.904(f)-7(b)(3) and (c). The explanation for the taxable year in which an overall domestic loss is sustained in §1.904(g)-1(a)(2) is clarified as well.

Section 1.904(g)-3(i) is reserved. The Treasury Department and the IRS will promulgate guidance addressing adjustments required under section 904(f)(3) with respect to disposition of property.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jeffrey L. Parry of the Office of Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.904(g)-3 also issued under 26 U.S.C. 904(g)(4). * * *

Par. 2. Section 1.904(f)-0 is amended as follows:

1. In §1.904(f)-1, entries for paragraphs (a)(2), (d)(4), and (g) are added.
2. In §1.904(f)-2, entries for paragraphs (c), (c)(1), (d)(3)(i), (d)(3)(ii), and (e) are added.
3. In §§1.904(f)-7 and 1.904(f)-8, paragraph entries are added.

The additions and revisions read as follows:

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

* * * * *

§1.904(f)-1 Overall foreign loss and the overall foreign loss account.

(a) * * *

(2) Application to post-1986 taxable years.

* * * * *

(d) * * *

(4) Adjustments for capital gains and losses.

* * * * *

(g) Effective/applicability date.

§1.904(f)-2 Recapture of overall foreign losses.

* * * * *

(c) Section 904(f)(1) recapture.

(1) In general.

* * * * *

(d) * * *

(3) * * *

(i) Foreign source gain.

(ii) U.S. source gain.

* * * * *

(e) Effective/applicability.

§1.904(f)-7 Separate limitation loss and the separate limitation loss account.

(a) Overview of regulations.

(b) Definitions.

(1) Separate category.

(2) Separate limitation income.

(3) Separate limitation loss.

(c) Separate limitation loss account.

(d) Additions to separate limitation loss accounts.

(1) General rule.

(2) Separate limitation losses of another taxpayer.

(3) Additions to separate limitation loss account created by loss carryovers.

(e) Reductions of separate limitation loss accounts.

(1) Pre-recapture reduction for amounts allocated to other taxpayers.

(2) Reduction for offsetting loss accounts.

(3) Reduction for amounts recaptured.

(f) Effective/applicability date.

§1.904(f)-8 Recapture of separate limitation loss accounts.

(a) In general.

(b) Effect of recharacterization of separate limitation income on associated taxes.

(c) Effective/applicability date.

§ 1.904(f)-0T [Removed]

Par. 3. Section 1.904(f)-0T is removed.

Par. 4. In § 1.904(f)-1, paragraphs (a)(2), (d)(4), and (g) are revised to read as follows:

§1.904(f)-1 Overall foreign loss and the overall foreign loss account.

(a) * * *

(2) Application to post-1986 taxable years. The principles of §§1.904(f)-1 through 1.904(f)-5 shall apply to any overall foreign loss sustained in taxable years beginning after December 31, 1986, modified so as to take into account the effect of statutory amendments.

* * * * *

(d) * * *

(4) Adjustments for capital gains and losses and qualified dividend income. If a taxpayer has capital gains or losses or qualified dividend income, as defined in section 1(h)(11), the taxpayer shall make adjustments to such capital gains and losses and qualified dividend income to the extent required under section 904(b)(2) and §1.904(b)-1 before applying the provisions of §1.904(f)-1. See §1.904(b)-1(h).

* * * * *

(g) Effective/applicability date. Paragraphs (a)(2) and (d)(4) of this section shall apply to taxable years beginning on or after January 1, 2012. Taxpayers may choose to apply paragraphs (a)(2) and (d)(4) of this section to other taxable years beginning after December 21, 2007, including periods covered by 26 CFR 1.904(f)-1T (revised as of April 1, 2010).

§ 1.904(f)-1T [Removed]

Par. 5. Section 1.904(f)-1T is removed.

Par. 6. In §1.904(f)-2, paragraphs (c)(1), (c)(5) Example 4, (d)(1), (d)(3), and (e) are revised to read as follows:

§1.904(f)-2 Recapture of overall foreign losses.

* * * * *

(c) * * *

(1) In general. In a taxable year in which a taxpayer elects the benefits of section 901 or section 30A, the section 904(f)(1) recapture amount is the amount of foreign source taxable income subject to recharacterization in a taxable year in which recapture of an overall foreign loss is required under paragraph (a) of this section. The section 904(f)(1) recapture amount equals the lesser of the aggregate amount of maximum potential recapture in all overall foreign loss accounts or fifty percent of the taxpayer's total foreign source taxable income. If the aggregate amount of maximum potential recapture in all overall foreign loss accounts exceeds fifty percent of the taxpayer's total foreign source taxable income, foreign source taxable income in each separate category with an overall foreign loss account is recharacterized in an amount equal to the section 904(f)(1) recapture amount, multiplied by the maximum potential recapture in the overall foreign loss account, divided by the aggregate amount of maximum potential recapture in all overall foreign loss accounts. The maximum potential recapture in an overall foreign loss account in a separate category is the lesser of the balance in that overall foreign loss account or the foreign source taxable income for the year in the same separate category as the loss account. If, in any taxable year, in accordance with sections 164(a) and 275(a)(4)(A), a taxpayer deducts rather than credits its foreign taxes, recapture is applied to the extent of the lesser of--

- (i) The balance in the overall foreign loss account in each separate category; or
- (ii) Foreign source taxable income (net of foreign taxes) in each separate category.

* * * * *

(5) * * *

Example 4. Y Corporation is a domestic corporation that does business in the United States and abroad. On December 31, 2007, the balance in Y's general category overall foreign loss account is \$500, all of which is attributable to a loss incurred in 2007. Y has no other loss accounts subject to recapture. For 2008, Y has U.S. source taxable income of \$400 and foreign source taxable income of \$300 in the general category and \$900 in the passive category. Under paragraph (c)(1) of this section, the amount of Y's general category income subject to recharacterization is the lesser of the aggregate maximum potential recapture or 50% of the total foreign source taxable income. In this case, Y's aggregate maximum potential recapture is \$300 (the lesser of the \$500 balance in the general category overall foreign loss account or \$300 foreign source income in the general category for the year), which is less than 50% of Y's total foreign source taxable income ($\$1200 \times 50\% = \600). Therefore, pursuant to paragraph (c) of this section, \$300 of foreign source income in the general category is recharacterized as U.S. source income. The balance in Y's general category overall foreign loss account is reduced to \$200 in accordance with §1.904(f)-1(e)(2).

* * * * *

(d) * * *

(1) In general. If a taxpayer disposes of property used or held for use predominantly without the United States in a trade or business during a taxable year and that property generates foreign source taxable income subject to a separate limitation to which paragraph (a) of this section applies, the applicable overall foreign loss account shall be recaptured as provided in paragraphs (d)(2), (d)(3), and (d)(4) of this section. See paragraph (d)(5) of this section for definitions. See the ordering rules under §1.904(g)-3(f) and (i) for coordination with other loss recapture under section 904(f) and (g).

* * * * *

(3) Dispositions where gain is recognized irrespective of section 904

(f)(3)--(i) Foreign source gain. If a taxpayer recognizes foreign source gain

in a separate category on the disposition of property described in paragraph (d)(1) of this section, and there is a balance in a taxpayer's overall foreign loss account that is attributable to a loss in such separate category after applying paragraph (c) of this section, an additional portion of such balance shall be recaptured in accordance with paragraphs (a) and (b) of this section. The amount recaptured shall be the lesser of such balance or the full amount of the foreign source gain recognized on the disposition that was not previously recharacterized.

(ii) U.S. source gain. If a taxpayer recognizes U.S. source gain on the disposition of property described in paragraph (d)(1) of this section, and there is a balance in a taxpayer's overall foreign loss account that is attributable to a loss in the separate category to which the income generated by such property is assigned after applying paragraph (c) of this section, an amount of the gain shall be treated as foreign source and an additional portion of such balance equal to that amount shall be recaptured in accordance with paragraphs (a) and (b) of this section. The amount of gain treated as foreign source and the amount of overall foreign loss recaptured shall be the lesser of the balance in the overall foreign loss account or the full amount of the gain recognized on the disposition.

* * * * *

(e) Effective/applicability date. Paragraphs (c)(1), (c)(5) Example 4, (d)(1), and (d)(3) of this section shall apply to taxable years beginning on or after January 1, 2012. Taxpayers may choose to apply paragraphs (c)(1), (c)(5) Example 4, (d)(1), and (d)(3)

of this section to other taxable years beginning after December 21, 2007, including periods covered by 26 CFR §1.904(f)-2T (revised as of April 1, 2010).

§ 1.904(f)-2T [Removed]

Par. 7. Section 1.904(f)-2T is removed.

Par. 8. Section 1.904(f)-7 is revised to read as follows:

§1.904(f)-7 Separate limitation loss and the separate limitation loss account.

(a) Overview of regulations. This section provides rules for determining a taxpayer's separate limitation losses, for establishing separate limitation loss accounts, and for making additions to and reducing such accounts for purposes of section 904(f). Section 1.904(f)-8 provides rules for recharacterizing the balance in any separate limitation loss account under the general recharacterization rule of section 904(f)(5)(C).

(b) Definitions. The definitions in paragraphs (b)(1) through (b)(4) of this section apply for purposes of this section and §§1.904(f)-8 and 1.904(g)-3.

(1) Separate category means each separate category of income described in section 904(d) and any other category of income described in §1.904-4(m). For example, income subject to section 901(j) or section 904(h)(10) is income in a separate category.

(2) Separate limitation income means, with respect to any separate category, the taxable income from sources outside the United States, separately computed for that category for the taxable year. Separate limitation income shall be determined by taking into account any adjustments for capital gains and losses and qualified dividend income, as defined in section 1(h)(11), under section 904(b)(2) and §1.904(b)-1. See §1.904(b)-1(h)(1)(i).

(3) Separate limitation loss means, with respect to any separate category, the amount by which the foreign source gross income in that category is exceeded by the sum of expenses, losses and other deductions (not including any net operating loss deduction under section 172(a) or any expropriation loss or casualty loss described in section 907(c)(4)(D)(iii)) properly apportioned or allocated to that separate category for the taxable year. Separate limitation losses shall be determined by taking into account any adjustments for capital gains and losses and qualified dividend income under section 904(b)(2) and §1.904(b)-1. See §1.904(b)-1(h)(1)(i).

(c) Separate limitation loss account. Any taxpayer that sustains a separate limitation loss that is allocated to reduce separate limitation income in one or more other separate categories of the taxpayer under the rules of §1.904(g)-3 must establish a separate limitation loss account for the loss with respect to each such other separate category. The balance in any separate limitation loss account represents the amount of such separate limitation loss that is subject to recapture in a given taxable year pursuant to §1.904(f)-8 and section 904(f)(5)(F). From year to year, amounts may be added to or subtracted from the balance in such loss accounts, as provided in paragraphs (d) and (e) of this section.

(d) Additions to separate limitation loss accounts--(1) General rule. A taxpayer's separate limitation loss as defined in paragraph (b)(3) of this section shall be added to the applicable separate limitation loss accounts at the end of its taxable year to the extent that the separate limitation loss reduces separate limitation income in one or more other separate categories in that taxable year or in a year to which the loss has

been carried back. For rules with respect to net operating loss carryovers, see paragraph (d)(3) of this section and §1.904(g)-3.

(2) Separate limitation losses of another taxpayer. If any portion of any separate limitation loss account of another taxpayer is allocated to the taxpayer in accordance with §1.1502-9 (relating to consolidated separate limitation losses) the taxpayer shall add such amount to its applicable separate limitation loss account.

(3) Additions to separate limitation loss account created by loss carryovers. The taxpayer shall add to each separate limitation loss account all net operating loss carryovers to the current taxable year to the extent that separate limitation losses included in the net operating loss carryovers reduced foreign source income in one or more other separate categories for the taxable year.

(e) Reductions of separate limitation loss accounts. The taxpayer shall subtract the following amounts from its separate limitation loss accounts at the end of its taxable year in the following order as applicable:

(1) Pre-recapture reduction for amounts allocated to other taxpayers. A separate limitation loss account is reduced by the amount of any separate limitation loss account that is allocated to another taxpayer in accordance with §1.1502-9 (relating to consolidated separate limitation losses).

(2) Reduction for offsetting loss accounts. A separate limitation loss account is reduced to take into account any netting of separate limitation loss accounts under §1.904(g)-3(d)(1).

(3) Reduction for amounts recaptured. A separate limitation loss account is reduced by the amount of any separate limitation income that is earned in the same

separate category as the separate limitation loss and that is recharacterized in accordance with §1.904(f)-8 (relating to recapture of separate limitation losses) or section 904(f)(5)(F) (relating to recapture of separate limitation loss accounts out of gain realized from certain dispositions).

(f) Effective/applicability date. This section applies to taxpayers that sustain separate limitation losses in taxable years beginning on or after January 1, 2012. Taxpayers may choose to apply this section to separate limitation losses sustained in other taxable years beginning after December 21, 2007, including periods covered by 26 CFR 1.904(f)-7T (revised as of April 1, 2010). For rules relating to taxable years beginning after December 31, 1986, and on or before December 21, 2007, see section 904(f)(5).

§ 1.904(f)-7T [Removed]

Par. 8. Section 1.904(f)-7T is removed.

Par. 9. Section 1.904(f)-8 is revised to read as follows:

§1.904(f)-8 Recapture of separate limitation loss accounts.

(a) In general. A taxpayer shall recapture a separate limitation loss account as provided in this section. If the taxpayer has a separate limitation loss account or accounts in any separate category (the “loss category”) and the loss category has income in a subsequent taxable year, the income shall be recharacterized as income in that other category or categories. The amount of income recharacterized shall not exceed the aggregate balance in all separate limitation loss accounts for the loss category as determined under §1.904(f)-7. If the taxpayer has more than one separate limitation loss account in a loss category, and there is not enough income in the loss

category to recapture all of the loss accounts, then separate limitation income in the loss category shall be recharacterized as separate limitation income in the other separate categories on a proportionate basis. This is determined by multiplying the total separate limitation income subject to recharacterization by a fraction, the numerator of which is the amount in a particular separate limitation loss account and the denominator of which is the total amount in all separate limitation loss accounts for the loss category.

(b) Effect of recharacterization of separate limitation income on associated taxes.

Recharacterization of income under paragraph (a) of this section shall not result in the recharacterization of any tax. The rules of §1.904-6, including the rules that the taxes are allocated on an annual basis and that foreign taxes paid on U.S. source income shall be allocated to the separate category that includes that U.S. source income (see §1.904-6(a)), shall apply for purposes of allocating taxes to separate categories. Allocation of taxes pursuant to §1.904-6 shall be made before the recapture of any separate limitation loss accounts of the taxpayer pursuant to the rules of this section.

(c) Effective/applicability date. This section applies to taxpayers that sustain separate limitation losses in taxable years beginning on or after January 1, 2012. Taxpayers may choose to apply this section to separate limitation losses sustained in other taxable years beginning after December 21, 2007, including periods covered by 26 CFR §1.904(f)-8T (revised as of April 1, 2010). For rules relating to taxable years beginning after December 31, 1986, and on or before December 21, 2007, see section 904(f)(5).

§ 1.904(f)-8T [Removed]

Par. 10. Section 1.904(f)-8T is removed:

Par. 11. Section 1.904(g)-0 is amended by adding the entries for §§1.904(g)-1, 1.904(g)-2, and 1.904(g)-3 to read as follows:

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

* * * * *

§1.904(g)-1 Overall domestic loss and the overall domestic loss account.

- (a) Overview of regulations.
- (b) Overall domestic loss accounts.
 - (1) In general.
 - (2) Taxable year in which overall domestic loss is sustained.
- (c) Determination of a taxpayer's overall domestic loss.
 - (1) Overall domestic loss defined.
 - (2) Domestic loss defined.
 - (3) Qualified taxable year defined.
 - (4) Method of allocation and apportionment of deductions.
- (d) Additions to overall domestic loss accounts.
 - (1) General rule.
 - (2) Overall domestic loss of another taxpayer.
 - (3) Adjustments for capital gains and losses.
- (e) Reductions of overall domestic loss accounts.
 - (1) Pre-recapture reduction for amounts allocated to other taxpayers.
 - (2) Reduction for amounts recaptured.
- (f) Effective/applicability date.

§1.904(g)-2 Recapture of overall domestic losses.

- (a) In general.
- (b) Determination of U.S. source taxable income for purposes of recapture.
- (c) Section 904(g)(1) recapture.
- (d) Effective/applicability date.

§1.904(g)-3 Ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for the recapture of separate limitation losses, overall foreign losses, and overall domestic losses.

- (a) In general.
- (b) Step One: Allocation of net operating loss and net capital loss carryovers.
 - (1) In general.
 - (2) Full net operating loss carryover.
 - (3) Partial net operating loss carryover.

- (4) Net capital loss carryovers.
- (c) Step Two: Section 904(b) adjustments.
- (d) Step Three: Allocation of separate limitation losses.
- (e) Step Four: Allocation of U.S. source losses.
- (f) Step Five: Recapture of overall foreign loss accounts.
- (g) Step Six: Recapture of separate limitation loss accounts.
- (h) Step Seven: Recapture of overall domestic loss accounts.
- (i) [Reserved].
- (j) Examples.
- (k) Effective/applicability date.

§ 1.904(g)-0T [Removed]

Par. 12. Section 1.904(g)-0T is removed:

Par. 13. Section 1.904(g)-1 is revised to read as follows:

§1.904(g)-1 Overall domestic loss and the overall domestic loss account.

(a) Overview of regulations. This section provides rules for determining a taxpayer's overall domestic losses, for establishing overall domestic loss accounts, and for making additions to and reducing such accounts for purposes of section 904(g). Section 1.904(g)-2 provides rules for recapturing the balance in any overall domestic loss account under the general recharacterization rule of section 904(g)(1). Section 1.904(g)-3 provides ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and the recapture of separate limitation losses, overall foreign losses and overall domestic losses.

(b) Overall domestic loss accounts--(1) In general. Any taxpayer that sustains an overall domestic loss under paragraph (c) of this section must establish an overall domestic loss account for such loss with respect to each separate category, as defined in §1.904(f)-7(b)(1), of the taxpayer in which foreign source income is offset by the domestic loss. The balance in each overall domestic loss account represents the amount of such overall domestic loss subject to recapture in a given taxable year. From

year to year, amounts may be added to or subtracted from the balances in such loss accounts as provided in paragraphs (d) and (e) of this section.

(2) Taxable year in which overall domestic loss is sustained. When a domestic loss is carried back or carried forward as part of a net operating loss, and offsets foreign source income in a carryover year, the resulting overall domestic loss is treated as sustained in the later of the year in which the domestic loss was incurred or the year to which the loss was carried. Accordingly, when a taxpayer incurs a domestic loss that is carried back as part of a net operating loss to offset foreign source income in a qualified taxable year, as defined in paragraph (c)(3) of this section, the resulting overall domestic loss is treated as sustained in the later year in which the domestic loss was incurred and not in the earlier year in which the loss offset foreign source income. In addition, when a taxpayer incurs a domestic loss that is carried forward as part of a net operating loss and applied to offset foreign source income in a later taxable year, the resulting overall domestic loss is treated as sustained in the later year in which the domestic loss offsets foreign source income and not in the earlier year in which the loss was incurred. For example, if a taxpayer incurs a domestic loss in the 2007 taxable year that is carried back to the 2006 qualified taxable year and offsets foreign source income in 2006, the resulting overall domestic loss is treated as sustained in the 2007 taxable year. If a taxpayer incurs a domestic loss in a pre-2007 taxable year that is carried forward to a post-2006 qualified taxable year and offsets foreign source income in the post-2006 year, the resulting overall domestic loss is treated as sustained in the post-2006 year. An overall domestic loss account is established, or increased under paragraph (d) of this section, at the end of the taxable year in which the overall

domestic loss is treated as sustained and will be recaptured from U.S. source income arising in subsequent taxable years.

(c) Determination of a taxpayer's overall domestic loss--(1) Overall domestic loss defined. For taxable years beginning after December 31, 2006, a taxpayer sustains an overall domestic loss--

(i) In any qualified taxable year in which its domestic loss for such taxable year offsets foreign source taxable income for the taxable year or for any preceding qualified taxable year by reason of a carryback; and

(ii) In any other taxable year in which the domestic loss for such taxable year offsets foreign source taxable income for any preceding qualified taxable year by reason of a carryback.

(2) Domestic loss defined. For purposes of this section and §§1.904(g)-2 and 1.904(g)-3, the term domestic loss means the amount by which the U.S. source gross income for the taxable year is exceeded by the sum of the expenses, losses, and other deductions properly apportioned or allocated to such income, taking into account any net operating loss carried forward from a prior taxable year, but not any loss carried back. If a taxpayer has any capital gains or losses or qualified dividend income, as defined in section 1(h)(11), the amount of the taxpayer's domestic loss that offsets foreign source income must be determined taking into account adjustments under section 904(b)(2). See §1.904(g)-1(d)(3) for further guidance.

(3) Qualified taxable year defined. For purposes of this section and §§1.904(g)-2 and 1.904(g)-3, the term qualified taxable year means any taxable year for which the taxpayer chooses the benefits of section 901.

(4) Method of allocation and apportionment of deductions. In determining its overall domestic loss, a taxpayer shall allocate and apportion expenses, losses, and other deductions to U.S. source gross income in accordance with sections 861(b) and 865 and the regulations thereunder, including §§1.861-8 through 1.861-14T.

(d) Additions to overall domestic loss accounts--(1) General rule. A taxpayer's overall domestic loss as determined under paragraph (c) of this section shall be added to the applicable overall domestic loss account at the end of its taxable year to the extent that the overall domestic loss either reduces foreign source income for the year (but only if such year is a qualified taxable year) or reduces foreign source income for a qualified taxable year to which the loss has been carried back.

(2) Overall domestic loss of another taxpayer. If any portion of any overall domestic loss of another taxpayer is allocated to the taxpayer in accordance with §1.1502-9 (relating to consolidated overall domestic losses) the taxpayer shall add such amount to its applicable overall domestic loss account.

(3) Adjustments for capital gains and losses. If the taxpayer has capital gains or losses or qualified dividend income, the amount by which a domestic loss is considered to reduce foreign source income in a taxable year shall equal the section 904(f)(5)(D) amount determined under §1.904(b)-1(h)(1)(iii), regardless of the amount of domestic loss that was determined before taking any section 904(b)(2) adjustments into account.

(e) Reductions of overall domestic loss accounts. The taxpayer shall subtract the following amounts from its overall domestic loss accounts at the end of its taxable year in the following order, as applicable:

(1) Pre-recapture reduction for amounts allocated to other taxpayers. An overall domestic loss account is reduced by the amount of any overall domestic loss which is allocated to another taxpayer in accordance with §1.1502-9 (relating to consolidated overall domestic losses).

(2) Reduction for amounts recaptured. An overall domestic loss account is reduced by the amount of any U.S. source income that is recharacterized in accordance with §1.904(g)-2(c) (relating to recapture under section 904(g)(1)).

(f) Effective/applicability date. This section applies to taxpayers that sustain an overall domestic loss for a taxable year beginning on or after January 1, 2012.

Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, including periods covered by 26 CFR §1.904(g)-1T (revised as of April 1, 2010).

§ 1.904(g)-1T [Removed]

Par. 14. Section 1.904(g)-1T is removed.

Par. 15. Section 1.904(g)-2 is revised to read as follows:

§1.904(g)-2 Recapture of overall domestic losses.

(a) In general. A taxpayer shall recapture an overall domestic loss as provided in this section. Recapture is accomplished by treating a portion of the taxpayer's U.S. source taxable income as foreign source income. The recharacterized income is allocated among and increases foreign source income in separate categories in proportion to the balances of the overall domestic loss accounts with respect to those separate categories. As a result, if the taxpayer chooses the benefits of section 901, the taxpayer's foreign tax credit limitation is increased. As provided in §1.904(g)-

1(e)(2), the balance in a taxpayer's overall domestic loss account with respect to a separate category is reduced at the end of each taxable year by the amount of loss recaptured during that taxable year. Recapture continues until the amount of U.S. source income recharacterized as foreign source income equals the amount in the overall domestic loss account.

(b) Determination of U.S. source taxable income for purposes of recapture. For purposes of determining the amount of an overall domestic loss subject to recapture, the taxpayer's taxable income from U.S. sources shall be computed in accordance with the rules set forth in §1.904(g)-1(c)(4). U.S. source taxable income shall be determined by taking into account adjustments for capital gains and losses and qualified dividend income in a similar manner to the adjustments made to foreign source taxable income under section 904(b)(2) and §1.904(b)-1, following the principles of §1.904(b)-1(h)(1)(i).

(c) Section 904(g)(1) recapture. The amount of any U.S. source taxable income subject to recharacterization in a taxable year in which paragraph (a) of this section applies is the lesser of the aggregate balance of the taxpayer's overall domestic loss accounts or 50 percent of the taxpayer's U.S. source taxable income (as determined under paragraph (b) of this section).

(d) Effective/applicability date. This section applies to taxpayers that sustain an overall domestic loss for a taxable year beginning on or after January 1, 2012.

Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, including periods covered by 26 CFR 1.904(g)-2T (revised as of April 1, 2010).

§ 1.904(g)-2T [Removed]

Par. 16. Section 1.904(g)-2T is removed.

Par. 17. Section 1.904(g)-3 is revised to read as follows:

§1.904(g)-3 Ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for the recapture of separate limitation losses, overall foreign losses, and overall domestic losses.

(a) In general. This section provides ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for the recapture of separate limitation losses, overall foreign losses, and overall domestic losses. The rules must be applied in the order set forth in paragraphs (b) through (i) of this section.

(b) Step One: Allocation of net operating loss and net capital loss carryovers--(1)
In general. Net operating losses from a current taxable year are carried forward or back to a taxable year in the following manner. Net operating losses that are carried forward pursuant to section 172 are combined with income or loss in the carryover year in the manner described in this paragraph (b). The combined amounts are then subject to the ordering rules provided in paragraphs (c) through (i) of this section. Net operating losses that are carried back to a prior taxable year pursuant to section 172 are allocated to income in the carryback year in the manner set forth in paragraphs (b)(2), (b)(3), (c), (d), and (e) of this section. The income in the carryback year to which the net operating loss is allocated is the foreign source income in each separate category and the U.S. source income after the application of sections 904(f) and 904(g) to income and loss in that previous year, including as a result of net operating loss carryovers or carrybacks from taxable years prior to the current taxable year.

(2) Full net operating loss carryover. If the full net operating loss (that remains after carryovers to other taxable years) is less than or equal to the taxable income in a particular taxable year (carryover year), and so can be carried forward in its entirety to such carryover year, U.S. source losses and foreign source losses in separate categories that are part of a net operating loss from a particular taxable year that is carried forward in its entirety shall be combined with the U.S. source income or loss and the foreign source income or loss in the same separate categories in the carryover year.

(3) Partial net operating loss carryover. If the full net operating loss (that remains after carryovers to other taxable years) exceeds the taxable income in a carryover year, and so cannot be carried forward in its entirety to such carryover year, the following rules apply:

(i) Any U.S. source loss (not to exceed the net operating loss carryover) shall be carried over to the extent of any U.S. source income in the carryover year.

(ii) If the net operating loss carryover exceeds the U.S. source loss carryover determined under paragraph (b)(3)(i) of this section, then separate limitation losses that are part of the net operating loss shall be tentatively carried over to the extent of separate limitation income in the same separate category in the carryover year. If the sum of the potential separate limitation loss carryovers determined under the preceding sentence exceeds the amount of the net operating loss carryover reduced by any U.S. source loss carried over under paragraph (b)(3)(i) of this section, then the potential separate limitation loss carryovers shall be reduced pro rata so that their sum equals such amount.

(iii) If the net operating loss carryover exceeds the sum of the U.S. and separate

limitation loss carryovers determined under paragraphs (b)(3)(i) and (ii) of this section, then a proportionate part of the remaining loss from each separate category shall be carried over to the extent of such excess and combined with the foreign source loss, if any, in the same separate categories in the carryover year.

(iv) If the net operating loss carryover exceeds the sum of all the loss carryovers determined under paragraphs (b)(3)(i), (ii), and (iii) of this section, then any U.S. source loss not carried over under paragraph (b)(3)(i) of this section shall be carried over to the extent of such excess and combined with the U.S. source loss, if any, in the carryover year.

(4) Net capital loss carryovers. Rules similar to the rules of paragraphs (b)(1) through (3) of this section apply for purposes of determining the components of a net capital loss carryover to a taxable year.

(c) Step Two: Section 904(b) adjustments. The taxpayer shall make any required adjustments to capital gains and losses and qualified dividend income under section 904(b)(2).

(d) Step Three: Allocation of separate limitation losses. The taxpayer shall allocate separate limitation losses sustained during the taxable year (increased, if appropriate, by any losses carried over under paragraph (b) of this section), in the following manner--

(1) The taxpayer shall allocate its separate limitation losses for the taxable year to reduce its separate limitation income in other separate categories on a proportionate basis, and increase its separate limitation loss accounts appropriately. To the extent a separate limitation loss in one separate category is allocated to reduce separate

limitation income in a second separate category, and the second category has a separate limitation loss account from a prior taxable year with respect to the first category, the two separate limitation loss accounts shall be netted against each other.

(2) If the taxpayer's separate limitation losses for the taxable year exceed the taxpayer's separate limitation income for the year, so that the taxpayer has separate limitation losses remaining after the application of paragraph (d)(1) of this section, the taxpayer shall allocate those losses to its U.S. source income for the taxable year, to the extent thereof, and shall increase its overall foreign loss accounts to that extent in accordance with §1.904(f)-1.

(e) Step Four: Allocation of U.S. source losses. The taxpayer shall allocate U.S. source losses sustained during the taxable year (increased, if appropriate, by any losses carried over under paragraph (b) of this section) to separate limitation income on a proportionate basis, and shall increase its overall domestic loss accounts to the extent of such allocation in accordance with §1.904(g)-1.

(f) Step Five: Recapture of overall foreign loss accounts. If the taxpayer's separate limitation income for the taxable year (reduced by any losses carried over under paragraph (b) of this section) exceeds the sum of the taxpayer's U.S. source loss and separate limitation losses for the year, so that the taxpayer has separate limitation income remaining after the application of paragraphs (d)(1) and (e) of this section, then the taxpayer shall recapture prior year overall foreign losses, if any, and reduce overall foreign loss accounts in accordance with §1.904(f)-2.

(g) Step Six: Recapture of separate limitation loss accounts. To the extent the taxpayer has remaining separate limitation income for the year after the application of

paragraph (f) of this section, then the taxpayer shall recapture prior year separate limitation losses, if any, in accordance with §1.904(f)-8 and reduce separate limitation loss accounts in accordance with §1.904(f)-7.

(h) Step Seven: Recapture of overall domestic loss accounts. If the taxpayer's U.S. source income for the year (reduced by any losses carried over under paragraph (b) of this section or allocated under paragraph (d) of this section, but not increased by any recapture of overall foreign loss accounts under paragraph (f) of this section) exceeds the taxpayer's separate limitation losses for the year, so that the taxpayer has U.S. source income remaining after the application of paragraph (d)(2) of this section, then the taxpayer shall recapture its prior year overall domestic losses, if any, and reduce overall domestic loss accounts in accordance with §1.904(g)-2.

(i) [Reserved]

(j) Examples. The following examples illustrate the rules of this section. Unless otherwise noted, all corporations use the calendar year as the U.S. taxable year.

Example 1. (i) Facts. (A) Z Corporation is a domestic corporation with foreign branch operations in Country B. For 2009, Z has a net operating loss of (\$500), determined as follows:

<u>General</u>	<u>Passive</u>	<u>US</u>
(\$300)	\$0	(\$200)

(B) For 2008, Z had the following taxable income and losses after application of section 904(f) and (g) to income and loss in 2008:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$400	\$200	\$110

(ii) Net operating loss allocation. Because Z's taxable income for 2008 exceeds its total net operating loss for 2009, the full net operating loss is carried back. Under Step 1, each component of the net operating loss is carried back and combined with its same category in 2008. See paragraph (b)(2) of this section. After allocation of the net operating loss, Z has the following taxable income and losses for 2008:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$100	\$200	(\$90)

(iii) Loss allocation. Under Step 4, the (\$90) of U.S. loss is allocated proportionately to reduce the general category and passive category income. Accordingly, \$30 ($\$90 \times \$100/\300) of the U.S. loss is allocated to general category income and \$60 ($\$90 \times \$200/\300) of the U.S. loss is allocated to passive category income, with a corresponding creation or increase to Z's overall domestic loss accounts.

Example 2. (i) Facts. (A) X Corporation is a domestic corporation with foreign branch operations in Country C. As of January 1, 2007, X has no loss accounts subject to recapture. For 2007, X has a net operating loss of (\$1400), determined as follows:

<u>General</u>	<u>Passive</u>	<u>US</u>
(\$400)	(\$200)	(\$800)

(B) X has no taxable income in 2005 or 2006 available for offset by a net operating loss carryback. For 2008, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$500	(\$100)	\$1200

(ii) Net operating loss allocation. Under Step 1, because X's total taxable income for 2008 of \$1600 ($\$1200 + \$500 - \100) exceeds the total 2007 net operating loss, the full \$1400 net operating loss is carried forward. Under paragraph (b)(2) of this section, each component of the net operating loss is carried forward and combined with its same category in 2008. After allocation of the net operating loss, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$100	(\$300)	\$400

(iii) Loss allocation. Under Step 3, \$100 of the passive category loss offsets the \$100 of general category income, resulting in a passive category separate limitation loss account with respect to general category income, and the other \$200 of passive category loss offsets \$200 of the U.S. source taxable income, resulting in the creation of an overall foreign loss account in the passive category.

Example 3. (i) Facts. Assume the same facts as in Example 2, except that in 2008, X had the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$200	(\$100)	\$1200

(ii) Net operating loss allocation. Under Step 1, because the total net operating loss for 2007 of (\$1400) exceeds total taxable income for 2008 of \$1300 (\$1200 + \$200 - \$100), X has a partial net operating loss carryover to 2008 of \$1300. Under paragraph (b)(3)(i) of this section, first, the \$800 U.S. source component of the net operating loss is allocated to U.S. income for 2008. The tentative general category carryover under paragraph (b)(3)(ii) of this section (\$200) does not exceed the remaining net operating loss carryover amount (\$500). Therefore, \$200 of the general category component of the net operating loss is next allocated to the general category income for 2008. Under paragraph (b)(3)(iii) of this section, the remaining \$300 of net operating loss carryover (\$1300 - \$800 - \$200) is carried over proportionally from the remaining net operating loss components in the general category (\$200, or \$400 total general category loss - \$200 general category loss already allocated) and passive category (\$200). Therefore, \$150 ($\$300 \times \$200/\$400$) of the remaining net operating loss carryover is carried over from the general category for 2007 and combined with the general category for 2008, and \$150 ($\$300 \times \$200/\400) of the remaining net operating loss carryover is carried over from the passive category for 2007 and combined with the passive category for 2008. After allocation of the net operating loss carryover from 2007 to the appropriate categories for 2008, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
(\$150)	(\$250)	\$400

(iii) Loss allocation. Under Step 3, the losses in the general and passive categories fully offset the U.S. source income, resulting in the creation of general category and passive category overall foreign loss accounts.

Example 4. (i) Facts. Assume the same facts as in Example 2, except that in 2008, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$200	\$200	(\$200)

(ii) Net operating loss allocation. Under Step 1, because the total net operating loss of (\$1400) exceeds total taxable income for 2008 of \$200 (\$200 + \$200 - \$200), X has a partial net operating loss carryover to 2008 of \$200. Because X has no U.S. source income in 2008, under paragraph (b)(3)(i) of this section no portion of the U.S. source component of the net operating loss is initially carried into 2008. Because the total tentative carryover under paragraph (b)(3)(ii) of this section of \$400 (\$200 in each of the general and passive categories) exceeds the net operating loss carryover amount, the tentative carryover from each separate category is reduced proportionately by \$100 ($\$200 \times \$200/\400). Accordingly, \$100 ($\$200 - \100) of the general category component of the net operating loss is carried forward and \$100 ($\$200 - \100) of the passive category component of the net operating loss is carried forward and combined with income in the same respective categories for 2008. After allocation of the net operating loss carryover from 2007, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$100	\$100	(\$200)

(iii) Loss allocation. Under Step 4, the \$200 U.S. source loss offsets the remaining \$100 of general category income and \$100 of passive category income, resulting in the creation of overall domestic loss accounts with respect to the general and passive categories.

Example 5. (i) Facts. Assume the same facts as in Example 2, except that in 2008, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$800	(\$100)	\$100

(ii) Net operating loss allocation. Under Step 1, because X's total net operating loss in 2007 of (\$1400) exceeds its total taxable income for 2008 of \$800 (\$100 + \$800 - \$100), X has a partial net operating loss carryover to 2008 of \$800. Under paragraph (b)(3)(i) of this section, \$100 of the U.S. source component of the net operating loss is allocated to U.S. income for 2008. The tentative general category carryover under paragraph (b)(3)(ii) of this section does not exceed the remaining net operating loss carryover amount. Therefore, \$400 of the general category component of the net operating loss is allocated to reduce general category income in 2008. Under paragraph (b)(3)(iii) of this section, of the remaining \$300 of net operating loss carryover (\$800 - \$100 - \$400), \$200 is carried forward from the passive category component of the net operating loss and combined with the passive category for 2008. Under paragraph (b)(3)(iv) of this section, the remaining \$100 (\$300 - \$200) of net operating loss carryover is carried forward from the U.S. source component of the net operating loss and combined with the U.S. source income (loss) for 2008. After allocation of the net operating loss carryover from 2007, X has the following taxable income and losses:

<u>General</u>	<u>Passive</u>	<u>US</u>
\$400	(\$300)	(\$100)

(iii) Loss allocation. (A) Under Step 3, the \$300 passive category loss offsets the \$300 of income in the general category, resulting in the creation of a passive category separate limitation loss account with respect to the general category.

(B) Under Step 4, the \$100 U.S. source loss offsets the remaining \$100 of the general category income, resulting in the creation of an overall domestic loss account with respect to the general category.

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

by a (\$400) domestic loss in that taxable year, giving rise to the creation of an overall domestic loss (ODL) account with respect to the passive category. As of January 1, 2008, Y has the following balances in its OFL, SLL, and ODL accounts:

	<u>General</u>		<u>US</u>
<u>OFL</u>		<u>SLL (Passive)</u>	<u>ODL (Passive)</u>
\$200		\$200	\$400

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

<u>General</u>	<u>Passive</u>	<u>US</u>
\$400	(\$100)	\$600

(ii) Loss allocation. Under Step 3, the \$100 of passive category loss offsets \$100 of the general category income, creating a passive category SLL account of \$100 with respect to the general category. Because there is an offsetting general category SLL account of \$200 with respect to the passive category from a prior taxable year, the two accounts are netted against each other so that all that remains is a \$100 general category SLL account with respect to the passive category.

(iii) OFL account recapture. Under Step 5, 50% of the remaining \$300, or \$150, of income in the general category is subject to recharacterization as U.S. source income as a recapture of part of the OFL account in the general category.

(iv) SLL account recapture. Under Step 6, \$100 of the remaining \$150 of income in the general category is recharacterized as passive category income as a recapture of the general category SLL account with respect to the passive category.

(v) ODL account recapture. Under Step 7, 50% of the \$600, or \$300, of U.S. source income is subject to recharacterization as foreign source passive category income as a recapture of a part of the ODL account with respect to the passive category. None of the \$150 of general category income that was recharacterized as U.S. source income under Step 5 is included here as income subject to recharacterization in connection with recapture of the overall domestic loss account.

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

<u>General</u>	<u>Passive</u>	<u>US</u>
\$50	\$400	\$450

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

<u>General</u>	<u>Passive</u>	<u>US</u>
<u>OFL</u>	<u>SLL (Passive)</u>	<u>ODL (Passive)</u>
\$50	\$0	\$100

(k) Effective/applicability date. This section applies to taxable years beginning on or after January 1, 2012 . Taxpayers may choose to apply this section to other taxable years beginning after December 31, 2006, including periods covered by 26 CFR §1.904(g)-3T (revised as of April 1, 2010).

§ 1.904(g)-3T [Removed]

Par. 18. Section 1.904(g)-3T is removed.

Par. 19. Section 1.1502-9 is revised to read as follows:

§1.1502-9 Consolidated overall foreign losses, separate limitation losses, and overall domestic losses.

(a) In general. This section provides rules for applying section 904(f) and (g) (including its definitions and nomenclature) to a group and its members. Generally, section 904(f) concerns rules relating to overall foreign losses (OFLs) and separate limitation losses (SLLs) and the consequences of such losses. Under section 904(f)(5), losses are computed separately in each category of income described in section 904(d)(1) or §1.904-4(m) (separate category). Section 904(g) concerns rules relating to overall domestic losses (ODLs) and the consequences of such losses. Paragraph (b) of this section defines terms and provides computational and accounting rules, including rules regarding recapture. Paragraph (c) of this section provides rules that apply to OFLs, SLLs, and ODLs when a member becomes or ceases to be a member of a group. Paragraph (d) of this section provides a predecessor and successor rule. Paragraph (e) of this section provides effective dates.

(b) Consolidated application of section 904(f) and (g). A group applies section 904(f) and (g) for a consolidated return year in accordance with that section, subject to the following rules:

(1) Computation of CSLI or CSLL and consolidated U.S.-source taxable income or CDL. The group computes its consolidated separate limitation income (CSLI) or consolidated separate limitation loss (CSLL) for each separate category under the principles of §1.1502-11 by aggregating each member's foreign-source taxable income or loss in such separate category computed under the principles of §1.1502-12, and taking into account the foreign portion of the consolidated items described in §1.1502-11(a)(2) through (a)(8) for such separate category. The group computes its consolidated U.S.-source taxable income or consolidated domestic loss (CDL) under similar principles.

(2) Netting CSLLs, CSLIs, and consolidated U.S.-source taxable income. The group applies section 904(f)(5) to determine the extent to which a CSLL for a separate category reduces CSLI for another separate category or consolidated U.S.-source taxable income.

(3) Netting CDL and CSLI. The group applies section 904(g)(2) to determine the extent to which a CDL reduces CSLI.

(4) CSLL, COFL, and CODL accounts. To the extent provided in section 904(f), the amount by which a CSLL for a separate category (the loss category) reduces CSLI for another separate category (the income category) will result in the creation of (or addition to) a CSLL account for the loss category with respect to the income category. Likewise, the amount by which a CSLL for a loss category reduces consolidated U.S.-

source taxable income will create (or add to) a consolidated overall foreign loss account (a COFL account). To the extent provided in section 904(g), the amount by which a CDL reduces CSLI will result in the creation of (or addition to) a consolidated overall domestic loss (CODL) account for the income category reduced by the CDL.

(5) Recapture of COFL, CSLL, and CODL accounts. In the case of a COFL account for a loss category, section 904(f)(1) and section 904(f)(3) recharacterize some or all of the foreign-source income in the loss category as U.S.-source income. In the case of a CSLL account for a loss category with respect to an income category, section 904(f)(5)(C) and section 904(f)(5)(F) recharacterize some or all of the foreign-source income in the loss category as foreign-source income in the income category. In the case of a CODL account, section 904(g)(3) recharacterizes some of the U.S.-source income as foreign-source income in the separate category that was offset by the CDL. The COFL account, CSLL account, or CODL account is reduced to the extent income is recharacterized with respect to such account.

(6) Intercompany transactions--(i) Nonapplication of section 904(f) disposition rules. Neither section 904(f)(3) (in the case of a COFL account) nor section 904(f)(5)(F) (in the case of a CSLL account) applies at the time of a disposition that is an intercompany transaction to which §1.1502-13 applies. Instead, section 904(f)(3) and section 904(f)(5)(F) apply only at such time and only to the extent that the group is required under §1.1502-13 (without regard to section 904(f)(3) and section 904(f)(5)(F)) to take into account any intercompany items resulting from the disposition, based on the COFL or CSLL account existing at the end of the consolidated return year during which the group takes the intercompany items into account.

(ii) Examples. Paragraph (b)(6)(i) of this section is illustrated by the following examples. The identity of the parties and the basic assumptions set forth in §1.1502-13(c)(7)(i) apply to the examples. Except as otherwise stated, assume further that the consolidated group recognizes no foreign source income other than as a result of the transactions described. The examples are as follows:

Example 1. (i) On June 10, year 1, S transfers nondepreciable property with a basis of \$100 and a fair market value of \$250 to B in a transaction to which section 351 applies. The property was predominantly used without the United States in a trade or business within the meaning of section 904(f)(3). B continues to use the property without the United States. The group has a COFL account in the relevant loss category of \$120 as of December 31, year 1.

(ii) Because the contribution from S to B is an intercompany transaction, section 904(f)(3) does not apply to result in any gain recognition in year 1. See paragraph (b)(5)(i) of this section.

(iii) On January 10, year 4, B ceases to be a member of the group. Because S did not recognize gain in year 1 under section 351, no gain is taken into account in year 4 under §1.1502-13. Thus, no portion of the group's COFL account is recaptured in year 4. For rules requiring apportionment of a portion of the COFL account to B, see paragraph (c)(2) of this section.

Example 2. (i) The facts are the same as in paragraph (i) of Example 1. On January 10, year 4, B sells the property to X for \$300. As of December 31, year 4, the group's COFL account is \$40. (The COFL account was reduced between year 1 and year 4 due to unrelated foreign-source income taken into account by the group.)

(ii) B takes into account gain of \$200 in year 4. The \$40 COFL account in year 4 recharacterizes \$40 of the gain as U.S. source. See section 904(f)(3).

Example 3. (i) On June 10, year 1, S sells nondepreciable property with a basis of \$100 and a fair market value of \$250 to B for \$250 cash. The property was predominantly used without the United States in a trade or business within the meaning of section 904(f)(3). The group has a COFL account in the relevant loss category of \$120 as of December 31, year 1. B predominantly uses the property in a trade or business without the United States.

(ii) Because the sale is an intercompany transaction, section 904(f)(3) does not require the group to take into account any gain in year 1. Thus, under paragraph (b)(5)(i) of this section, the COFL account is not reduced in year 1.

(iii) On January 10, year 4, B sells the property to X for \$300. As of December 31, year 4, the group's COFL account is \$60. (The COFL account was reduced between year 1 and year 4 due to unrelated foreign-source income taken into account by the group.)

(iv) In year 4, S's \$150 intercompany gain and B's \$50 corresponding gain are taken into account to produce the same effect on consolidated taxable income as if S and B were divisions of a single corporation. See §1.1502-13(c). All of B's \$50 corresponding gain is recharacterized under section 904(f)(3). If S and B were divisions of a single corporation and the intercompany sale were a transfer between the divisions, B would succeed to S's \$100 basis in the property and would have \$200 of gain (\$60 of which would be recharacterized under section 904(f)(3)), instead of a \$50 gain. Consequently, S's \$150 intercompany gain and B's \$50 corresponding gain are taken into account, and \$10 of S's gain is recharacterized under section 904(f)(3) as U.S. source income to reflect the \$10 difference between B's \$50 recharacterized gain and the \$60 recomputed gain that would have been recharacterized.

(c) Becoming or ceasing to be a member of a group--(1) Adding separate accounts on becoming a member. At the time that a corporation becomes a member of a group (a new member), the group adds to the balance of its COFL, CSLL or CODL account the balance of the new member's corresponding OFL account, SLL account or ODL account. A new member's OFL account corresponds to a COFL account if the account is for the same loss category. A new member's SLL account corresponds to a CSLL account if the account is for the same loss category and with respect to the same income category. A new member's ODL account corresponds to a CODL account if the account is with respect to the same income category. If the group does not have a COFL, CSLL or CODL account corresponding to the new member's account, it creates a COFL, CSLL or CODL account with a balance equal to the balance of the member's account.

(2) Apportionment of consolidated account to departing member--(i) In general. A group apportions to a member that ceases to be a member (a departing member) a portion of each COFL, CSLL and CODL account as of the end of the year during which

the member ceases to be a member and after the group makes the additions or reductions to such account required under paragraphs (b)(4), (b)(5), and (c)(1) of this section (other than an addition under paragraph (c)(1) of this section attributable to a member becoming a member after the departing member ceases to be a member). The group computes such portion under paragraph (c)(2)(ii) of this section, as limited by paragraph (c)(2)(iii) of this section. The departing member carries such portion to its first separate return year after it ceases to be a member. Also, the group reduces each account by such portion and carries such reduced amount to its first consolidated return year beginning after the year in which the member ceases to be a member. If two or more members cease to be members in the same year, the group computes the portion allocable to each such member (and reduces its accounts by such portion) in the order that the members cease to be members.

(ii) Departing member's portion of group's account. A departing member's portion of a group's COFL, CSLL or CODL account for a loss category is computed based upon the member's share of the group's assets that generate income subject to recapture at the time that the member ceases to be a member. Under the characterization principles of §§1.861-9T(g)(3) and 1.861-12T, the group identifies the assets of the departing member and the remaining members that generate U.S.-source income (domestic assets) and foreign-source income (foreign assets) in each separate category. The assets are characterized based upon the income that the assets are reasonably expected to generate after the member ceases to be a member. The member's portion of a group's COFL or CSLL account for a loss category is the group's COFL or CSLL account, respectively, multiplied by a fraction, the numerator of which is

the value of the member's foreign assets for the loss category and the denominator of which is the value of the foreign assets of the group (including the departing member) for the loss category. The member's portion of a group's CODL account for each income category is the group's CODL account multiplied by a fraction, the numerator of which is the value of the member's domestic assets and the denominator of which is the value of the domestic assets of the group (including the departing member). The value of the domestic and foreign assets is determined under the asset valuation rules of §1.861-9T(g)(1) and (2) using either tax book value, fair market value, or alternative tax book value under the method chosen by the group for purposes of interest apportionment as provided in §1.861-9T(g)(1)(ii). For purposes of this paragraph (c)(2)(ii), §1.861-9T(g)(2)(iv) (assets in intercompany transactions) shall apply, but §1.861-9T(g)(2)(iii) (adjustments for directly allocated interest) shall not apply. If the group uses the tax book value method, the member's portions of COFL, CSLL, and CODL accounts are limited by paragraph (c)(2)(iii) of this section. In addition, for purposes of this paragraph (c)(2)(ii), the tax book value of assets transferred in intercompany transactions shall be determined without regard to previously deferred gain or loss that is taken into account by the group as a result of the transaction in which the member ceases to be a member. The assets should be valued at the time the member ceases to be a member, but values on other dates may be used unless this creates substantial distortions. For example, if a member ceases to be a member in the middle of the group's consolidated return year, an average of the values of assets at the beginning and end of the year (as provided in §1.861-9T(g)(2)) may be used or, if a member ceases to be a member in the early part of the group's consolidated return

year, values at the beginning of the year may be used, unless this creates substantial distortions.

(iii) Limitation on member's portion for groups using tax book value method. If a group uses the tax book value method of valuing assets for purposes of paragraph (c)(2)(ii) of this section and the aggregate of a member's portions of COFL and CSLL accounts for a loss category (with respect to one or more income categories) determined under paragraph (c)(2)(ii) of this section exceeds 150 percent of the actual fair market value of the member's foreign assets in the loss category, the member's portion of the COFL or CSLL accounts for the loss category shall be reduced (proportionately, in the case of multiple accounts) by such excess. In addition, if the aggregate of a member's portions of CODL accounts (with respect to one or more income categories) determined under paragraph (c)(2)(ii) of this section exceeds 150 percent of the actual fair market value of the member's domestic assets, the member's portion of the CODL accounts shall be reduced (proportionately, in the case of multiple accounts) by such excess. This rule does not apply in the case of COFL or CSLL accounts if the departing member and all other members that cease to be members as part of the same transaction own all (or substantially all) the foreign assets in the loss category. In the case of CODL accounts, this rule does not apply if the departing member and all other members that cease to be members as part of the same transaction own all (or substantially all) the domestic assets.

(iv) Determination of values of domestic and foreign assets binding on departing member. The group's determination of the value of the member's and the group's domestic and foreign assets for a loss category is binding on the member, unless the

Commissioner concludes that the determination is not appropriate. The common parent of the group must attach a statement to the return for the taxable year that the departing member ceases to be a member of the group that sets forth the name and taxpayer identification number of the departing member, the amount of each COFL and CSLL for each loss category and each CODL that is apportioned to the departing member under this paragraph (c)(2), the method used to determine the value of the member's and the group's domestic and foreign assets in each such loss category, and the value of the member's and the group's domestic and foreign assets in each such loss category. The common parent must also furnish a copy of the statement to the departing member.

(v) Anti-abuse rule. If a corporation becomes a member and ceases to be a member, and a principal purpose of the corporation becoming and ceasing to be a member is to transfer the corporation's OFL account, SLL account or ODL account to the group or to transfer the group's COFL, CSLL or CODL account to the corporation, appropriate adjustments will be made to eliminate the benefit of such a transfer of accounts. Similarly, if any member acquires assets or disposes of assets (including a transfer of assets between members of the group and the departing member) with a principal purpose of affecting the apportionment of accounts under paragraph (c)(2)(i) of this section, appropriate adjustments will be made to eliminate the benefit of such acquisition or disposition.

(vi) Examples. The following examples illustrate the rules of this paragraph (c):

Example 1. (i) On November 6, year 1, S, a member of the P group, a consolidated group with a calendar consolidated return year, ceases to be a member of the group. On December 31, year 1, the P group has a \$40 COFL account for the general category, a \$20 CSLL account for the general category (that is, the loss category) with respect to the passive category (that is, the income category), and a \$10 CODL account with respect to the passive category (that is, the income category). No

member of the group has foreign-source income or loss in year 1. The group apportions its interest expense according to the tax book value method.

(ii) On November 6, year 1, the group identifies S's assets and the group's assets (including S's assets) expected to produce foreign-source general category income. Use of end-of-the-year values will not create substantial distortions in determining the relative values of S's and the group's relevant assets on November 6, year 1. The group determines that S's relevant assets have a tax book value of \$2,000 and a fair market value of \$2,200. Also, the group's relevant assets (including S's assets) have a tax book value of \$8,000. On November 6, year 1, S has no assets expected to produce U.S. source income.

(iii) Under paragraph (c)(2)(ii) of this section, S takes a \$10 COFL account for the general category ($\$40 \times \$2000/\$8000$) and a \$5 CSLL account for the general category with respect to the passive category ($\$20 \times \$2000/\$8000$). S does not take any portion of the CODL account. The limitation described in paragraph (c)(2)(iii) of this section does not apply because the aggregate of the COFL and CSLL accounts for the general category that are apportioned to S (\$15) is less than 150% of the actual fair market value of S's general category foreign assets ($\$2,200 \times 150\%$).

Example 2. (i) Assume the same facts as in Example 1, except that the fair market value of S's general category foreign assets is \$4 as of November 6, year 1.

(ii) Under paragraph (c)(2)(iii) of this section, S's COFL and CSLL accounts for the general category must be reduced by \$9, which is the excess of \$15 (the aggregate amount of the accounts apportioned under paragraph (c)(2)(ii) of this section) over \$6 (150% of the \$4 actual fair market value of S's general category foreign assets). S thus takes a \$4 COFL account for the general category ($\$10 - (\$9 \times \$10/\$15)$) and a \$2 CSLL account for the general category with respect to the passive category ($\$5 - (\$9 \times \$5/\$15)$).

Example 3. (i) Assume the same facts as in Example 1, except that S also has assets that are expected to produce U.S. source income.

(ii) On November 6, year 1, the group identifies S's assets and the group's assets (including S's assets) expected to produce U.S. source income. Use of end-of-the-year values will not create substantial distortions in determining the relative values of S's and the group's relevant assets on November 6, year 1. The group determines that S's relevant assets have a tax book value of \$3,000 and a fair market value of \$2,500. Also, the group's relevant assets (including S's assets) have a tax book value of \$6,000.

(iii) Under paragraph (c)(2)(ii) of this section, S takes a \$5 CODL account ($\$10 \times \$3,000/\$6,000$), in addition to the COFL and CSLL accounts determined in Example 1. The limitation described in paragraph (c)(2)(iii) of this section does not apply because the CODL account that is apportioned to S (\$5) is less than 150% of the actual fair market value of S's U.S. assets ($\$2,500 \times 150\%$).

(d) Predecessor and successor. A reference to a member includes, as the context may require, a reference to a predecessor or successor of the member. See §1.1502-1(f).

(e) Effective/applicability date. This section applies to consolidated return years beginning on or after January 1, 2012, for which the return is due (without extensions) after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. Taxpayers may choose to apply the provisions of this section to other consolidated return years beginning after December 31, 2006, including periods covered by 26 CFR 1.1502-9T (revised as of April 1, 2010). For rules relating to overall foreign losses and separate limitation losses in consolidated return years beginning on or before December 21, 2007, see 26 CFR 1.1502-9 (revised as of April 1, 2007).

§ 1.1502-9T [Removed]

Par. 20. Section 1.1502-9T is removed.

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