

category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006 separate category for passive category income.

(2) *Losses related to pre-2007 separate categories for shipping, financial services income or general limitation income*—(i) *Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for shipping income, financial services income or general limitation income.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance, or balances, shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's post-2006 separate category for general category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income.* To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006 separate category for general category income.

(3) *Losses related to a pre-2007 separate category for high withholding tax interest*—(i) *Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for high withholding tax interest.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's

last taxable year beginning before January 1, 2007, the amount of such balance shall be allocated on the first day of the taxpayer's next taxable year on a pro rata basis to the taxpayer's post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the same pre-2007 separate category for high withholding tax interest are allocated under § 1.904-2T(i)(1). If the taxpayer has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then any loss account balance in that category shall be allocated to the post-2006 separate category for passive category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for high withholding tax interest.* To the extent that a taxpayer has a balance in a separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years on a pro rata basis as income in the post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the pre-2007 separate category for high withholding tax interest are allocated under § 1.904-2T(i)(1). If the taxpayer has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then the loss account balance shall be recaptured in subsequent taxable years solely as income in the post-2006 separate category for passive category income.

(4) *Elimination of certain separate limitation loss accounts.* After application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for passive category income for which income is to be recaptured as passive category income, as determined under those same provisions, shall be eliminated. Similarly, after application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for general category income for which income is to be recaptured as general category income, as determined under those same provisions, shall be eliminated.

(5) *Alternative method.* In lieu of applying the rules of paragraphs (h)(1) through (h)(3) of this section, a taxpayer may apply the principles of paragraphs (g)(1) and (g)(2) of this section to

determine recapture in taxable years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in taxable years beginning before January 1, 2007.

(6) *Effective/applicability date.* This paragraph (h) shall apply to taxable years of United States taxpayers beginning after December 31, 2006 and ending on or after December 21, 2007.

(7) *Expiration date.* The applicability of this paragraph (h) expires on December 20, 2010.

**Linda E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 14, 2007.

**Eric Solomon,**

*Assistant Secretary of the Treasury (Tax Policy).*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[TD 9371]

RIN 1545-BH14

#### Treatment of Overall Foreign and Domestic Losses

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations under section 904(g) of the Internal Revenue Code (Code) relating to the recapture of overall domestic losses. Section 402 of the American Jobs Creation Act of 2004 (AJCA) enacted new section 904(g) of the Code to provide for the recapture of overall domestic losses. These regulations provide guidance needed to comply with 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. The text of these temporary regulations also serves as the text of the proposed regulations (REG-141399-07) published in the Proposed Rules section in this issue of the **Federal Register**.

**DATES:** *Effective Date:* These regulations are effective on *December 21, 2007*.

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

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:****Background**

Section 402 of the AJCA enacted new section 904(g) of the Code to provide for the recharacterization of U.S. source income as foreign source income where a taxpayer's foreign tax credit limitation has been reduced as a result of an overall domestic loss. See Public Law 108-357, 118 Stat. 1418 (October 22, 2004), as corrected by the Gulf Opportunity Zone Act of 2005, Public Law 109-135, 119 Stat. 2577 (December 22, 2005). The primary reason for enacting these provisions was "to create parity in the treatment of overall domestic losses and overall foreign losses in order to prevent the double taxation of income." H.R. Rep. No. 108-548, at 187 (June 16, 2004); see also S. Rep. No. 108-192, at 19-20 (November 7, 2003).

When a U.S. source loss is allocated to reduce foreign source income, the foreign tax credit limitation is reduced for the taxable year, which may result in excess foreign tax credits. Any such excess foreign taxes may be credited, if at all, in a subsequent (or the preceding) taxable year. In addition, U.S. source taxable income in a subsequent taxable year is not offset by the U.S. source loss allocated to foreign source income in the prior taxable year, and U.S. tax on such U.S. source taxable income cannot be offset by the foreign tax credit carryforward. This may lead to the double taxation of foreign source income over time. The overall domestic loss recapture provisions amend this result.

Section 904(g)(1) generally provides that a portion of a taxpayer's U.S. source income is recharacterized as foreign source income in an amount equal to the lesser of (1) the amount of the overall domestic loss for years prior to such taxable year and (2) fifty percent of the taxpayer's U.S. source income for such taxable year. Section 904(g)(2) generally defines an overall domestic loss for this purpose as any domestic loss to the extent it offsets foreign source taxable income for the current year or any preceding taxable year by reason of a carryback. Section 904(g)(4) provides that the Secretary of the Treasury shall prescribe such regulations as may be necessary to coordinate the overall domestic loss provisions with the overall foreign loss provisions.

Similar rules were first enacted as a part of the Tax Reform Act of 1976, Public Law 94-455, 90 Stat. 1531

(1976), in section 904(f) to deal with overall foreign losses. Under the overall foreign loss provisions, a portion of foreign source taxable income earned after an overall foreign loss year is recharacterized as U.S. source taxable income for foreign tax credit purposes. Unless a taxpayer elects a higher percentage, generally no more than 50 percent of the foreign source taxable income earned in any particular taxable year is recharacterized as U.S. source taxable income. Recapturing the overall foreign loss reduces the foreign tax credit limitation in one or more years following an overall foreign loss.

The separate limitation loss provisions of section 904(f)(5) were added by the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085 (1986) (the 1986 Act) and amended by the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647, 102 Stat. 3342 (1988). Other amendments to the overall foreign loss provisions were made by the AJCA as well.

Regulations addressing overall foreign losses under section 904(f) were published in the **Federal Register** (52 FR 31992) on August 25, 1987 (the 1987 regulations) and updated by regulations published in the **Federal Register** (71 FR 24516) on April 25, 2006 (the 2006 regulations). Additional guidance was provided in Notice 89-3, 1989-1 CB 623, regarding ordering rules for the allocation of net operating losses, overall foreign losses, and separate limitation losses; the recapture of overall foreign losses and separate limitation losses; and the allocation of U.S. source losses. The section 904(f) regulations have not been amended to reflect changes to the Code since the Tax Reform Act of 1976 or to incorporate the rules of Notice 89-3. See § 601.601(d)(2)(ii)(b).

These temporary regulations provide guidance needed to comply with enactment of the overall domestic loss regime, as well as provide updated guidance with respect to overall foreign losses and separate limitation losses.

**Explanation of Provisions****I. Overall Domestic Losses**

The temporary regulations include rules in §§ 1.904(g)-1T and 1.904(g)-2T which address the establishment, maintenance, and recapture of overall domestic loss accounts.

**A. Overall Domestic Loss Accounts**

Section 1.904(g)-1T(b)(1) provides that taxpayers must establish overall domestic loss accounts for an overall domestic loss. It further provides that a

separate overall domestic loss account must be maintained for each separate category of foreign source income that is offset by a domestic loss.

Section 1.904(g)-1T(b)(2) explains when an overall domestic loss is sustained. Generally, an overall domestic loss is treated as sustained in the later of the taxable years in which the domestic loss is incurred or the foreign source income offset by the domestic loss is earned. Accordingly, in the case of a domestic loss that is carried back to offset foreign source income in a prior taxable year in which the taxpayer elects to credit foreign taxes, the resulting overall domestic loss is treated as sustained in the taxable year the domestic loss is incurred, not in the prior taxable year in which the domestic loss offsets foreign source income. In the case of a domestic loss that is carried forward to offset foreign source income in a later taxable year, however, the overall domestic loss is treated as sustained in the year in which the domestic loss offsets foreign source income, not the earlier year in which the domestic loss is incurred.

Accordingly, if a taxpayer incurs a domestic loss in a pre-2007 taxable year, and the loss is carried forward as part of a net operating loss and applied to offset foreign source income in a post-2006 taxable year, the resulting overall domestic loss is treated as sustained in the post-2006 taxable year.

Section 1.904(g)-1T(c) provides that an overall domestic loss is sustained when a domestic loss offsets foreign source taxable income in the same taxable year or a preceding taxable year by reason of a carryback, provided the taxpayer has elected to take a credit for its foreign taxes in the year of the offset. A domestic loss is the amount by which U.S. source gross income is exceeded by deductions properly allocated and apportioned thereto. See § 1.904(g)-1T(c).

Section 1.904(g)-1T(d) describes additions to overall domestic loss accounts. This includes any overall domestic losses of the taxpayer, as determined above, as well as any allocation from another taxpayer of an overall domestic loss account under § 1.1502-9T, described in Part V of this preamble, and certain adjustments for capital gains and losses. Section 1.904(g)-1T(e) describes reductions to overall domestic loss accounts, including reductions for recaptured amounts and any allocation to another taxpayer of an overall domestic loss account under § 1.1502-9T.

### *B. Recapture of Overall Domestic Losses*

Section 1.904(g)–2T provides that overall domestic losses are recaptured by treating a portion of a taxpayer's U.S. source taxable income as foreign source income. If the taxpayer has overall domestic loss accounts attributable to more than one separate category, the recharacterized income will be allocated among those categories on a pro rata basis. The amount of U.S. source income subject to recapture is the lesser of the aggregate balance in the overall domestic loss account, or fifty percent of the taxpayer's U.S. source taxable income. Unlike the overall foreign loss recapture provisions in section 904(f), section 904(g) does not permit a taxpayer to elect to recharacterize more than fifty percent of its U.S. source taxable income. Recapture continues until the balance in the overall domestic loss account has been reduced to zero.

### **II. Separate Limitation Losses**

As discussed below, the 1987 regulations do not reflect the enactment of the separate limitation loss provisions of section 904(f)(5) as part of the 1986 Act. These temporary regulations include new provisions regarding the establishment and recapture of separate limitation loss accounts. Section 1.904(f)–7T provides that taxpayers must establish a separate limitation loss account with respect to a separate category to the extent a foreign source loss in that category offsets foreign source income in another separate category. This section also provides definitions and rules relating to the maintenance of these accounts.

Section 1.904(f)–8T provides rules for the recapture of separate limitation loss accounts. Separate limitation loss accounts are recaptured by recharacterizing a portion of the foreign source income in the separate category with the loss account as income in the separate category in which foreign source income of a prior year was offset to create the loss account. The amount of foreign source income subject to recharacterization is the lesser of the balance in a separate limitation loss account or the amount of foreign source income for the taxable year in that same separate category. There is no fifty-percent limitation with respect to separate limitation loss account recapture. If there is more than one separate limitation loss account in a single separate category and the aggregate balance in all those loss accounts exceeds the income in the separate category, income is recharacterized in proportion to the balance in each account. Recapture with

respect to a particular separate limitation loss account continues until the balance in the separate limitation loss account has been reduced to zero.

### **III. Overall Foreign Loss**

The 1987 regulations set forth rules governing the determination and maintenance of overall foreign loss accounts, as well as the recapture of overall foreign losses and the allocation of net operating losses and net capital losses. The regulations do not reflect changes made to the overall foreign loss rules of section 904(f) as part of the 1986 Act and certain subsequent changes to section 904(f), such as the enactment in the AJCA of section 904(f)(3)(D), addressing dispositions of stock in controlled foreign corporations. These temporary regulations update the existing regulations to take into account certain changes made to the overall foreign loss rules since the 1987 regulations were promulgated.

Section 1.904(f)–1(a) states that the 1987 regulations apply to taxpayers that sustain overall foreign losses (as defined in paragraph (c) of that section) in taxable years beginning after December 31, 1975. However, paragraph (c) of that section only defines overall foreign losses for taxable years beginning after December 31, 1982, and before January 1, 1987.

While it is beyond the scope of this project to undertake a full revision of the 1987 regulations to reflect all intervening statutory changes made to section 904(f), the Treasury Department and the IRS believe that as part of this regulations project the principles of the 1987 regulations should be extended to apply to overall foreign losses sustained in taxable years beginning after December 31, 1986, modified so as to take into account statutory amendments. New § 1.904(f)–1T(a)(2) adopts such a rule.

The Treasury Department and the IRS believe the application of the fifty-percent limitation on the amount of foreign source income subject to recapture in a taxable year under the overall foreign loss recapture provisions also needs to be clarified as part of this regulations project. Section 1.904(f)–2(c)(1) provides that the amount of foreign source taxable income subject to recapture in a taxable year is the lesser of the balance in the applicable overall foreign loss account in a given separate category or fifty percent of the taxpayer's foreign source taxable income in that same separate category. For example, recapture of a general category overall foreign loss would be limited to the lesser of the balance in the general category overall foreign loss account or

fifty percent of the general category taxable income for the taxable year.

The legislative history to the 1986 Act clarifies that the fifty-percent limitation is to be applied to the full amount of the taxpayer's foreign source income, not on a separate-category-by-separate-category basis. See H.R. Conf. Rep. No. 99–841 at II–590 (1986). This clarification was incorporated by reference into Notice 89–3, paragraph 3(b), and reflected in instructions to Form 1118 (Foreign Tax Credit—Corporations). The temporary regulations modify the fifty-percent limitation to reflect this clarification.

Section 1.904(f)–2T(c)(1) provides that the foreign source taxable income subject to recharacterization is 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 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 separate category's allocable portion of the section 904(f)(1) recapture amount. The maximum potential recapture from any separate category is the lesser of the balance in the overall foreign loss account or the foreign source taxable income for the current year in the same separate category.

Other revisions to the 1987 regulations include updating provisions to reflect statutory and regulatory changes affecting capital gains and losses, in particular those provisions that were superseded by the regulations promulgated under section 904(b) in TD 9141 (July 20, 2004). In addition, § 1.904(f)–3 is made obsolete by the ordering rules added in § 1.904(g)–3T and is removed accordingly.

### **IV. Coordination of Overall Foreign Losses, Separate Limitation Losses, and Overall Domestic Losses**

Under the specific grant of regulatory authority in section 904(g)(4), these temporary regulations provide ordering rules for coordinating the section 904(f) overall foreign loss and separate limitation loss provisions and the section 904(g) overall domestic loss provisions.

Section 1.904(g)–3T 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. While these rules generally follow the ordering rules set

forth in Notice 89-3, some changes were appropriate to take into account the enactment of the overall domestic loss provisions.

*A. Step One: Allocation of Net Operating Loss and Net Capital Loss Carryovers*

These temporary regulations generally follow the rules of Notice 89-3 for the carryover and carryback of net operating losses. Under § 1.904(g)-3T(b)(1), net operating losses that are carried back to a prior year are allocated to income in the carryback year in accordance with the allocation rules for absorbing and allocating net operating loss carryovers. However, the income against which the net operating loss is allocated is the income after application of the overall foreign loss, separate limitation loss and overall domestic loss allocation and recapture rules for the carryback year.

The rules for net operating loss carryforwards vary for full and partial carryovers of the net operating loss. In the case of a full net operating loss carryover, the U.S. source losses and foreign losses in separate categories that are part of the net operating loss are carried forward and combined with U.S. source income or loss and foreign source income or loss in the same categories as the respective portions of the net operating loss.

In the case of a partial net operating loss carryover, several steps apply. In applying these steps it is important to distinguish the net operating loss, which is the total net operating loss, and the net operating loss carryover, which is the portion of the net operating loss that is absorbed in the carryover year. First, the U.S. source portion of the net operating loss (but not in excess of the net operating loss carryover) is carried over to the extent of U.S. source income in the carryover year. Second, the separate limitation losses that are part of the net operating loss are tentatively carried to the extent of taxable income in the same separate category. This amount is tentative because the total amount of matching net operating losses and separate limitation income may exceed the net operating loss carryover amount remaining after the first step. To the extent the total amount of these tentative loss carryovers is in fact limited by the amount of the remaining net operating loss carryover, then the tentative carryovers in each separate category are reduced on a pro rata basis so that their sum equals the amount of the remaining net operating loss carryover amount.

Third, any net operating loss carryover remaining after the first and second steps is carried over

proportionately from any remaining loss in each separate category and combined with foreign source loss, if any, in the same separate categories in the carryover year. Finally, any remaining U.S. source loss is carried over to the extent of the net operating loss carryover remaining after the third step, if any, and combined with U.S. source loss, if any, in the carryover year.

The temporary regulations deviate from the net operating loss rules of Notice 89-3 in the final two steps. The temporary regulations require the U.S. source loss and foreign source losses in the separate categories that are carried over to be combined with U.S. source income or loss and foreign source income or loss in the same categories as the respective portions of the net operating loss. Then, the temporary regulations provide these losses are allocated against other income as part of the general loss allocation rules for current year losses. Notice 89-3, however, requires the allocation of the net operating loss against income in other separate categories before allocation of current year losses. The Treasury Department and the IRS believe there is no difference in result whether the net operating losses carried into a taxable year are allocated before or at the same time as current year losses, given the treatment of U.S. losses in § 1.904(g)-3T. However, the approach of the temporary regulations provides added simplicity in application of the ordering rules as well as greater consistency with the rules for full net operating loss carryovers.

The rules for the allocation of net operating losses apply similarly to net capital loss carryovers.

*B. Step Two: Allocation of Separate Limitation Losses*

Separate limitation losses are first allocated to separate limitation income for the taxable year in other separate categories on a proportionate basis. Separate limitation loss accounts are increased as a result of any such allocations. To the extent the separate limitation losses exceed separate limitation income for the year, those losses are allocated against U.S. income, if any, for the taxable year and overall foreign loss accounts are increased.

Unlike Notice 89-3, the temporary regulations also provide that offsetting separate limitation loss accounts are netted against one another. For example, if a taxpayer has a separate limitation loss account in the general category with respect to passive category income, and in the next year incurs a passive category separate limitation loss that offsets general category income, the two

accounts will be netted against each other, rather than both being carried forward until each one is recaptured.

*C. Step Three: Allocation of U.S. Source Loss*

U.S. source losses are allocated against separate limitation income on a proportionate basis, and overall domestic loss accounts are increased appropriately. Under the ordering rules in Notice 89-3, U.S. losses sustained in the current taxable year are allocated after all other losses are allocated and after separate limitation losses and overall foreign losses are recaptured. With the addition of section 904(g), Congress expressed that domestic losses and foreign source losses should be treated with greater parity. To that end, the Treasury Department and the IRS believe the ordering rules of Notice 89-3 should be amended. Accordingly, the temporary regulations provide that U.S. losses are allocated in the same manner as foreign losses, before any income is recharacterized.

*D. Step Four: Recapture of Overall Foreign Loss Accounts*

To the extent a taxpayer has any separate limitation income for the taxable year after losses are allocated in steps one through three, a portion of such income will be subject to recharacterization in order to recapture prior year overall foreign losses, if any.

*E. Step Five: Recapture of Separate Limitation Loss Accounts*

To the extent a taxpayer has any separate limitation income for the taxable year after overall foreign losses are recaptured in step four, then such income will be subject to recharacterization in order to recapture prior year separate limitation losses, if any.

*F. Step Six: Recapture of Overall Domestic Loss Accounts*

To the extent a taxpayer has any U.S. source income after losses are allocated in steps one through three, but not taking into account any foreign source income that is recharacterized as U.S. source income under step four, then a portion of such income will be subject to recharacterization in order to recapture prior year overall domestic losses, if any.

The temporary regulations coordinate the overall foreign loss and overall domestic loss regimes by providing that the recapture of overall foreign and domestic loss accounts is done independently. Accordingly, income recharacterized under one recapture provision is not taken into account in

determining the amount of income subject to recharacterization under the other recapture provision. For example, foreign source income that is recharacterized as U.S. source income in order to recapture an overall foreign loss account will not then be included in the determination of U.S. source income subject to recharacterization as foreign source income in order to recapture an overall domestic loss account.

#### V. Consolidated Overall Domestic Loss Accounts—§ 1.1502-9T

Section 1.1502-9T revises § 1.1502-9 to include rules for the application of section 904(g) to consolidated groups and their members. Section 1.1502-9 provides rules only for the application of section 904(f) to consolidated groups and their members. Under those rules, consolidated overall foreign loss (COFL) accounts and consolidated separate limitation loss (CSLL) accounts are determined by the consolidated group on an aggregate basis under the principles of §§ 1.1502-11 and 1.1502-12. When a new member joins the group, its separate overall foreign loss and separate limitation loss accounts are combined with the appropriate COFL and CSLL accounts of the group. When a member leaves the group, it is allocated a pro rata portion of each of the group's COFL and CSLL accounts based on the member's share of the group's assets that generate income subject to recharacterization under the corresponding loss account. The temporary regulations do not alter these provisions addressing COFL and CSLL accounts. The revisions simply extend these principles to provide parallel treatment for consolidated overall domestic loss accounts.

#### Effective/Applicability Dates

The effective date for these regulations is December 21, 2007. The regulations generally apply to taxable years beginning after December 21, 2007. However, taxpayers may choose to apply the overall domestic loss provisions of the regulations in other taxable years beginning after December 31, 2006. In the alternative, taxpayers may use any reasonable method consistently applied for those years, including one based on the ordering rules of Notice 89-3.

#### 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. For applicability of the Regulatory Flexibility Act, see the cross-referenced

notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f), these regulations have been 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.

#### 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 is amended by adding an entry in numerical order to read in part as follows:

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

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

■ **Par. 2.** Section 1.904-0 is amended by revising the section heading and introductory text to read as follows:

#### § 1.904-0 Outline of regulation provisions.

This section lists the headings for §§ 1.904-1 through 1.904-7.

\* \* \* \* \*

■ **Par. 3.** Section 1.904(b)-0 is added. The entries for §§ 1.904(b)-1 and 1.904(b)-2 in § 1.904-0 are redesignated as entries in new § 1.904(b)-0.

#### § 1.904(b)-0 Outline of regulation provisions.

This section lists the headings for §§ 1.904(b)-1 and 1.904(b)-2.

■ **Par. 4.** Section 1.904(f)-0 is added and amended as follows:

■ 1. The entries for §§ 1.904(f)-1, 1.904(f)-2, 1.904(f)-3, 1.904(f)-4, 1.904(f)-5, 1.904(f)-6 and 1.904(f)-12 in § 1.904-0 are redesignated as entries in new § 1.904(f)-0.

■ 2. The entry for § 1.904(f)-1(a) is redesignated as § 1.904(f)-1(a)(1) and a new entry for § 1.904(f)-1(a)(2) is added.

■ 3. The entries for § 1.904(f)-1(d)(2), (d)(3), and (d)(4) are revised and the entry for § 1.904(f)-1(d)(5) is removed.

■ 4. The entries for § 1.904(f)-2(c) and (c)(1) are revised.

■ 5. The entries for § 1.904(f)-3 are removed.

■ 6. New entries for §§ 1.904(f)-7 and 1.904(f)-8 are added.

■ The additions and revisions read as follows:

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

This section lists the headings for §§ 1.904(f)-1 through 1.904(f)-8 and 1.904(f)-12.

\* \* \* \* \*

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

(a)(1) Overview of regulations.

(2) [Reserved]. For further guidance, see the entry for § 1.904(f)-1T(a)(2) in § 1.904(f)-0T.

\* \* \* \* \*

(d) \* \* \*  
(2) Overall foreign losses of another taxpayer.

(3) Additions to overall foreign loss account created by loss carryovers.

(4) [Reserved]. For further guidance, see the entry for § 1.904(f)-1T(d)(4) in § 1.904(f)-0T.

\* \* \* \* \*

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

\* \* \* \* \*

(c) and (c)(1) [Reserved]. For further guidance, see the entries for § 1.904(f)-2T(c) and (c)(1) in § 1.904(f)-0T.

\* \* \* \* \*

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

[Reserved]. For further guidance, see the entries for § 1.904(f)-7T in § 1.904(f)-0T.

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

[Reserved]. For further guidance, see the entries for § 1.904(f)-8T in § 1.904(f)-0T.

■ **Par. 5.** Section 1.904(f)-0T is added to read as follows:

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

This section lists the headings for §§ 1.904(f)-1T, 1.904(f)-2T, 1.904(f)-7T and 1.904(f)-8T.

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

(a)(1) [Reserved]. For further guidance, see the entry for § 1.904(f)-1(a)(1) in § 1.904(f)-0.

(2) Application to post-1986 taxable years.

(b) through (d)(3) [Reserved]. For further guidance, see the entries for § 1.904(f)-1(b) through (d)(3) in § 1.904(f)-0.

(d)(4) Adjustments for capital gains and losses.

(e) through (f) [Reserved]. For further guidance, see the entries for § 1.904(f)-1(e) through (f) in § 1.904(f)-0.

(g) Effective/applicability date.

(h) Expiration date.

§ 1.904(f)-2T *Recapture of overall foreign loss (temporary).*

(a) and (b) [Reserved]. For further guidance, see the entries for § 1.904(f)-2(a) and (b) in § 1.904(f)-0.

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

- (1) In general.  
 (c)(2) through (d) [Reserved]. For further guidance, see the entries for § 1.904(f)-2(c)(2) through (d) in § 1.904(f)-0.  
 (e) Effective/applicability date.  
 (f) Expiration date.

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

- (a) Overview of regulations.  
 (b) Definitions.  
 (1) Separate category.  
 (2) Separate limitation income.  
 (3) Separate limitation loss.  
 (4) 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.  
 (g) Expiration date.

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

- (a) In general.  
 (b) Effect of recharacterization of separate limitation income on associated taxes.  
 (c) Effective/applicability date.  
 (d) Expiration date.

**■ Par. 6.** Section 1.904(f)-1 is amended as follows:

- 1. Redesignate paragraph (a) as (a)(1).  
 ■ 2. Add a new paragraph (a)(2).  
 ■ 3. In paragraph (d)(1), remove the language “paragraph (d)(4) of this section” and add the language “paragraph (d)(3) of this section” in its place.  
 ■ 4. Remove paragraphs (d)(2), (d)(5), and *Example 4* and *Example 5* in paragraph (f).  
 ■ 5. Redesignate paragraph (d)(3) as paragraph (d)(2), and paragraph (d)(4) as paragraph (d)(3).  
 ■ 6. In newly-redesignated paragraph (d)(3), remove the language “1.904(f)-1(d)(5)” and add the language “1.904(f)-1(d)(4)” in its place.  
 ■ 7. Add new paragraphs (d)(4) and (g).  
 ■ The revisions and additions read as follows:

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

- \* \* \* \* \*  
 (a) \* \* \*  
 (2) [Reserved]. For further guidance, see § 1.904(f)-1T(a)(2).  
 \* \* \* \* \*  
 (d) \* \* \*  
 (4) [Reserved]. For further guidance, see § 1.904(f)-1T(d)(4).  
 \* \* \* \* \*

- (g) [Reserved]. For further guidance, see § 1.904(f)-1T(g).

**■ Par. 7.** Section 1.904(f)-1T is added to read as follows:

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

- (a)(1) [Reserved]. For further guidance, see § 1.904(f)-1(a)(1).  
 (2) *Application to post-1986 taxable years.* The principles of §§ 1.904(f)-1 through 1.904(f)-5 shall apply to overall foreign loss sustained in taxable years beginning after December 31, 1986, modified so as to take into account the effect of statutory amendments.  
 (b) through (d)(3) [Reserved]. For further guidance, see § 1.904(f)-1(b) through (d)(3).  
 (d)(4) *Adjustments for capital gains and losses.* If a taxpayer has capital gains or losses, the taxpayer shall make adjustments to such capital gains and losses to the extent required under section 904(b)(2) and § 1.904(b)-1 before applying the provisions of § 1.904(f)-1T. See § 1.904(b)-1(h).  
 (e) and (f) [Reserved]. For further guidance, see § 1.904(f)-1(e) and (f).  
 (g) *Effective/applicability date.* This section applies to taxable years beginning after *December 21, 2007*.  
 (h) *Expiration date.* The applicability of this section expires on December 20, 2010.

**■ Par. 8.** Section 1.904(f)-2 is amended as follows:

- 1. Revise paragraph (c)(1).  
 ■ 2. Revise paragraph (c)(5) *Example 4*.  
 ■ 3. Add a new paragraph (e).  
 ■ The revisions and addition read as follows:

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

- \* \* \* \* \*  
 (c) \* \* \* (1) [Reserved]. For further guidance, see § 1.904(f)-2T(c)(1).  
 (5) \* \* \*  
*Example 4.* [Reserved]. For further guidance see § 1.904(f)-2T(c)(5) *Example 4*.  
 \* \* \* \* \*

- (e) [Reserved]. For further guidance, see § 1.904(f)-2T(e).

**■ Par. 9.** Section 1.904(f)-2T is added to read as follows:

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

- (a) and (b) [Reserved]. For further guidance, see § 1.904(f)-2(a) and (b).  
 (c) *Section 904(f)(1) recapture—(1) In general.* In a year in which a taxpayer elects the benefits of section 901 or 30A, the amount of foreign source taxable income subject to recharacterization in a taxable year in which paragraph (a) of this section is applicable is 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 any account is the lesser of the balance in that overall foreign loss account (after reduction of such accounts in accordance with § 1.904(f)-1(e)) or the foreign source taxable income for the year in the same separate category as the loss account. If, in any year, in accordance with section 164(a) and section 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 minus foreign taxes in each separate category.

(c)(2) through (5) *Example 3* [Reserved]. For further guidance, see § 1.904(f)-2(c)(2) through (5) *Example 3*.

*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 percent 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 \$600, or 50 percent of total foreign source taxable income (\$1200 × 50%). 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 by \$300 to \$200 in accordance with § 1.904(f)-1(e)(2).

(c)(5) *Example 5* through (d) [Reserved]. For further guidance, see § 1.904(f)-2(c)(5) *Example 5* through § 1.904(f)-2(d).

(e) *Effective/applicability date.* This section applies to taxable years beginning after *December 21, 2007*.

(f) *Expiration date.* The applicability of this section expires on *December 20, 2010*.

■ Par. 10. Section 1.904(f)-3 is revised to read as follows:

**§ 1.904(f)-3 Allocation of net operating losses and net capital losses.**

For rules relating to the allocation of net operating losses and net capital losses, see § 1.904(g)-3T.

■ Par. 11. Sections 1.904(f)-7, 1.904(f)-7T, 1.904(f)-8, and 1.904(f)-8T are added to read as follows:

**§ 1.904(f)-7 Separate limitation loss and the separate limitation loss account. [Reserved].**

For further guidance, see § 1.904(f)-7T.

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

(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 reductions from such accounts for purposes of section 904(f). Section 1.904(f)-8T 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 (4) of this section apply for purposes of this section and §§ 1.904(f)-8T and 1.904(g)-3T.

(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 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 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)(B)(iii)) properly allocated and apportioned thereto for the taxable year. Separate limitation losses are determined separately for each separate category. Accordingly, income and deductions attributable to a separate category are not netted with income and deductions attributable to another separate category for purposes of determining the amount of a separate limitation loss. Separate limitation losses shall be determined by taking into account any adjustments for capital gains and losses 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 of the taxpayer under the rules of § 1.904(g)-3T must establish a separate limitation loss account for the loss. The taxpayer must establish separate loss accounts for each separate category in which a separate limitation loss is incurred that is allocated to reduce other separate limitation income. A separate account must then be established for each separate category to which a portion of the loss is allocated. The balance in any separate limitation loss account represents the amount of separate limitation income that is subject to recharacterization (as income in another separate category) in a subsequent year pursuant to § 1.904(f)-8T 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 the taxable year to the extent that the separate limitation loss has reduced separate limitation income in one or more other separate categories of the taxpayer during the taxable year. For rules with respect to net operating loss carryovers, see paragraph (d)(3) of this section and § 1.904(g)-3T.

(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 § 1.1502-9T (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 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 which is allocated to another taxpayer in accordance with § 1.1502-9T (relating to consolidated separate limitation losses).

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

(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 that resulted in the account and that is recharacterized in accordance with § 1.904(f)-8T (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 dispositions).

(f) *Effective/applicability date.* This section applies to taxpayers that sustain separate limitation losses in taxable years beginning after *December 21, 2007*. For taxable years beginning after *December 31, 1986*, and on or before *December 21, 2007*, see section 904(f)(5).

(g) *Expiration date.* The applicability of this section expires on *December 20, 2010*.

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

[Reserved]. For further guidance, see § 1.904(f)-8T.

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

(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 separate limitation loss accounts for the loss category as determined under § 1.904(f)-7T, including the aggregate separate limitation loss accounts from the loss category not previously recaptured under this paragraph (a). 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 the entire amount in all the loss accounts, then separate limitation income in the loss category shall be recharacterized as separate limitation income in the separate limitation loss categories on a proportionate basis. This is determined by multiplying the total separate limitation income subject to recapture by a fraction, the numerator of which is the amount in a particular loss account and the denominator of which is the total amount in all loss accounts for the separate category.

(b) *Effect of recapture 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 after December 21, 2007. For taxable years beginning after December 31, 1986, and on or before December 21, 2007, see section 904(f)(5).

(d) *Expiration date.* The applicability of this section expires on December 20, 2010.

■ **Par. 11.** Section 1.904(g)-0 is added to read as follows:

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

This section lists the headings for §§ 1.904(g)-1 through 1.904(g)-3.

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

[Reserved]. For further guidance, see the entries for § 1.904(g)-1T in § 1.904(g)-0T.

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

[Reserved]. For further guidance, see the entries for § 1.904(g)-2T in § 1.904(g)-0T.

*§ 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 recapture of separate limitation losses, overall foreign losses, and overall domestic losses.*

[Reserved]. For further guidance, see the entries for § 1.904(g)-3T in § 1.904(g)-0T.

■ **Par. 12.** Section 1.904(g)-0T is added to read as follows:

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

This section lists the headings for §§ 1.904(g)-1T through 1.904(g)-3T.

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

- (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.
    - (g) Expiration date.

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

- (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.
- (e) Expiration date.

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

- (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: Allocation of separate limitation losses.
- (d) Step Three: Allocation of U.S. source losses.
- (e) Step Four: Recapture of overall foreign loss accounts.

(f) Step Five: Recapture of separate limitation loss accounts.

(g) Step Six: Recapture of overall domestic loss accounts.

(h) Examples.

(i) Effective/applicability date.

(j) Expiration date.

■ **Par. 13.** Sections 1.904(g)-1, 1.904(g)-1T, 1.904(g)-2, 1.904(g)-2T, 1.904(g)-3, and 1.904(g)-3T are added to read as follows:

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

[Reserved]. For further guidance, see § 1.904(g)-1T.

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

(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 reductions from such accounts for purposes of section 904(g). Section 1.904(g)-2T 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)-3T 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 account for such loss. Separate overall domestic loss accounts must be maintained with respect to each separate category 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 year. From year to year, amounts may be added to or subtracted from the balances in such accounts as provided in paragraphs (d) and (e) of this section.

(2) *Taxable year in which overall domestic loss is sustained.* 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. Similarly, 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. The overall domestic loss account is established at the end of the later of the taxable year in which the domestic loss arose or the qualified taxable year to which the loss is carried and applied to offset foreign source income, 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)-2T and 1.904(g)-3T, 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, the amount of the taxpayer's domestic loss shall be determined by taking into account adjustments under section 904(b)(2) and § 1.904(b)-1. See § 1.904(b)-1(h)(1)(iii).

(3) *Qualified taxable year defined*. For purposes of this section and §§ 1.904(g)-2T and 1.904(g)-3T, 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. gross income in accordance with sections 861(b) and 865 and the regulations thereunder, including §§ 1.861-8T 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 § 1.1502-9T (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, the amount by which an overall domestic loss reduces foreign source income in a taxable year shall be determined in accordance with § 1.904(b)-1(h)(1)(i) and (iii).

(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, if 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 § 1.1502-9T (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)-2T(c) (relating to recapture under section 904(g)(1)).

(f) *Effective/applicability date*. This section applies to any taxpayer that sustains an overall domestic loss for a taxable year beginning after December 21, 2007. Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, as well.

(g) *Expiration date*. The applicability of this section expires on December 20, 2010.

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

[Reserved]. For further guidance, see § 1.904(g)-2T.

#### **§ 1.904(g)-2T Recapture of overall domestic losses (temporary).**

(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 elects the benefits of section 901, the taxpayer's foreign tax credit limitation is increased. As provided in § 1.904(g)-1T(f)(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 such time as 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)-1T(c)(4).

(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 is applicable is the lesser of the aggregate balance in taxpayer's overall domestic loss accounts in each separate category (after reduction of such account in accordance with § 1.904(g)-1T(e)) or fifty 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 any taxpayer that sustains an overall domestic loss for a taxable year beginning after December 21, 2007. Taxpayers may choose to apply this section to overall domestic losses sustained in other taxable years beginning after December 31, 2006, as well.

(e) *Expiration date.* The applicability of this section expires on *December 20, 2010*.

**§ 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 recapture of separate limitation losses, overall foreign losses, and overall domestic losses.**

[Reserved]. For further guidance, see § 1.904(g)–3T.

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

(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 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 (g) 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 (g) 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) and (3), (c), and (d) 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. 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) First, 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: 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 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 one against the 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 (c)(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 appropriately.

(d) *Step Three: 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 appropriately.

(e) *Step Four: 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 (c)(1) and (d) of this section, then the taxpayer shall recapture prior year overall foreign losses, if any, in accordance with §§ 1.904(f)–2 and 1.904(f)–2T.

(f) *Step Five: Recapture of separate limitation loss accounts.* To the extent the taxpayer has remaining separate limitation income for the year after the application of paragraph (e) of this section, then the taxpayer shall recapture prior year separate limitation loss accounts, if any, in accordance with § 1.904(f)–8T.

(g) *Step Six: 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 (c) of this section, but not increased by any recapture of overall foreign loss accounts under paragraph (e) 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 (c)(2) of this section, then the taxpayer shall recapture its prior year overall domestic losses, if any, in accordance with § 1.904(g)-2T.

(h) *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:

General	Passive	US
(\$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:

General	Passive	US
\$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:

General	Passive	US
\$100	\$200	(\$90)

(iii) *Loss allocation.* Under Step 3, 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:

General	Passive	US
(\$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:

General	Passive	US
\$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:

General	Passive	US
\$100	(\$300)	\$400

(iii) *Loss allocation.* Under Step 2, \$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:

General	Passive	US
\$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:

General	Passive	US
(\$150)	(\$250)	\$400

(iii) *Loss allocation.* Under Step 2, 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:

General	Passive	US
\$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:

General	Passive	US
\$100	\$100	(\$200)

(iii) *Loss allocation.* Under Step 3, 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:

General	Passive	US
\$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:

General	Passive	US
\$400	(\$300)	(\$100)

(iii) *Loss allocation.* (A) Under Step 2, 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 3, 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:

General		US
OFL	Passive SLL	Passive ODL
\$200	\$200	\$400

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

General	Passive	US
\$400	(\$100)	\$600

(ii) *Loss allocation.* Under Step 2, 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 4, 50 percent 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 5, \$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 6, 50 percent 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.

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

General	Passive	US
\$50	\$400	\$450

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

General		Passive	US
OFL	Passive SLL	General SLL	Passive ODL
\$50	\$0	\$0	\$100

(i) *Effective/applicability date.* This section applies to taxable years beginning after *December 21, 2007*. Taxpayers may choose to apply this section to other taxable years beginning after December 31, 2006, as well.

(j) *Expiration date.* The applicability of this section expires on *December 20, 2010*.

■ **Par. 15.** Section 1.904(i)–0 is added. The entries for § 1.904(i)–1 in § 1.904–0 are redesignated as entries for new § 1.904(i)–0.

#### § 1.904(i)–0 Outline of regulation provisions.

This section lists the headings for § 1.904(i)–1.

■ **Par. 16.** Section 1.904(j)–0 is added. The entries for § 1.904(j)–1 in § 1.904–0 are redesignated as entries for new § 1.904(j)–0.

#### § 1.904(j)–0 Outline of regulation provisions.

This section lists the headings for § 1.904(j)–1.

■ **Par. 17.** Section 1.1502–9 is revised to read as follows:

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

[Reserved]. For further guidance, see § 1.1502–9T.

■ **Par. 18.** Section 1.1502–9T is added to read as follows:

#### § 1.1502–9T Consolidated overall foreign losses, separate limitation losses, and overall domestic losses (temporary).

(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 (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) shall 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 shall 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 (3) recharacterizes 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 (F) recharacterizes 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 (5)(F) applies 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 (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 or fair market 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 percent 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 percent 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 percent

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 after *December 21, 2007*. Taxpayers may choose to apply the provisions of this section relating to overall domestic losses to other consolidated return years beginning after December 31, 2006, as well. 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).

(f) *Expiration date.* The applicability of this section expires on *December 20, 2010*.

**Linda E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 14, 2007.

**Eric Solomon,**

*Assistant Secretary of the Treasury (Tax Policy).*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 300

[TD 9370]

RIN 1545-BG88

#### User Fees Relating to Enrollment To Perform Actuarial Services

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations relating to user fees for the initial and renewed enrollment to become an enrolled actuary. The charging of user fees is authorized by the Independent Offices Appropriations Act (IOAA) of 1952.

**DATES:** *Effective Date:* These regulations are effective on December 21, 2007.

*Applicability Date:* For date of applicability, see § 300.0(c).

#### FOR FURTHER INFORMATION CONTACT:

Concerning cost methodology, Eva J. Williams at (202) 435-5514; concerning the final regulations, Kimberly Mattonen at (202) 622-4940 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

## Background

The Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) ordered the Secretary of Labor and the Secretary of Treasury to establish a Joint Board for the Enrollment of Actuaries. 29 U.S.C. 1241. The Joint Board shall, by regulation, establish reasonable standards and qualifications for persons performing actuarial services and the Joint Board shall enroll such individuals who, upon application, satisfy such standards and qualifications. 29 U.S.C. 1242(a). The regulations at 20 CFR Part 901, Subpart B address eligibility for enrollment and renewal of enrollment. Pursuant to the Joint Board's bylaws, the Secretary of the Treasury is to appoint an Executive Director to the Board who has the delegated authority to administer the Board's enrollment program. The Secretary of the Treasury has delegated these functions to the Internal Revenue Service and the costs of these activities are borne by the Service.

20 CFR 901.11(d)(4) provides for a reasonable non-refundable fee for applications for renewal of enrollment. Form 5434-A, "Application for Renewal of Enrollment" presently states that the renewal fee is \$25. Final 26 CFR 300.7 and 300.8 establish separate \$250 user fees for the enrollment and renewal of enrollment process. These fees represent the IRS's costs in administering the program, and the \$250 fee for renewal of enrollment will supplant the \$25 fee.

## Authority

The IOAA of 1952 (31 U.S.C. 9701) authorizes agencies to prescribe regulations that establish charges for services provided by the agency. The charges must be fair and be based on the costs to the Government, the value of the service to the recipient, the public policy or interest served, and other relevant facts. The IOAA of 1952 provides that regulations implementing user fees are subject to policies prescribed by the President, which are currently set forth in OMB Circular A-25, 58 FR 38142 (July 15, 1993) (the OMB Circular).

The OMB Circular encourages user fees for government-provided services that confer benefits on identifiable recipients over and above those benefits received by the general public. Under the OMB Circular, an agency that seeks to impose a user fee for government-provided services must calculate its full cost of providing those services. In general, a user fee should be set at an amount in order for the agency to recover the cost of providing the special service, unless the Office of