

and no reduction was made to U.S. source income. In situations where U.S. source income is reduced (the loss to be allocated exceeds foreign income in other categories), you must follow the rules described below under **Recapture of prior year overall foreign loss**.

**Note:** *If, for any tax year, you are required to allocate a foreign loss, you will need to make certain adjustments to income you receive in the loss category in later years. See **Recharacterization of income** below.*

**2. Recapture of prior year overall foreign loss.**— If you had an overall foreign loss in a prior year that offset U.S. source income, a part of your foreign income (in the same category as the loss) is treated as U.S. source income in each following tax year. The part that is treated as U.S. source income is the **smallest** of: **(a)** the amount of overall foreign loss not recaptured in earlier years, **(b)** 50% or more of your taxable income from foreign sources from all categories, or **(c)** the amount from line 14, less any adjustment for allocation of losses from other categories, described on page 7.

Reduce the income on line 14 by entering (in parentheses) on line 15 the smallest of **(a)**, **(b)**, or **(c)** above. This is the amount of the recapture. Be sure to attach your computation. If you elect to recapture more of an overall foreign loss than is required, you must show in your computation the percentage of taxable income recaptured and the dollar amount of the recapture.

Regulations section 1.904(f)-1(b) requires that you attach a statement to Form 1116 showing the balance in

each separate limitation overall foreign loss account.

**3. Recharacterization of income.**— If, in 1994, you reduced your foreign taxable income in the category shown at the top of Form 1116 by a pro rata share of a loss from another category, you must recharacterize in 1995 all or part of any income you receive in 1995 in that loss category. Increase the amount on line 14 by entering on line 15 any recharacterized income.

Also include on line 15 any income required to be recharacterized in 1995 as income in the category shown at the top of Form 1116 because of a foreign loss allocation in prior tax years.

**Example.** Using the same facts in the example under 1 on page 7, in the subsequent year (1996), you have \$5,000 of general limitation income, \$3,000 of passive income, and \$500 of high withholding tax interest. Because \$1,600 of the general limitation loss was used to reduce your passive income in 1995, \$1,600 of your 1996 general limitation income must be recharacterized as passive income. Similarly, \$400 of the general limitation income must be recharacterized as high withholding tax interest. On your 1996 Form 1116 for passive income, you would enter \$1,600 on line 15. On your 1996 Form 1116 for high withholding tax interest, you would enter \$400 on line 15.

**Note:** *Recharacterization of income from a separate category does not result in recharacterizing any tax.*

**4. Allocation of U.S. losses.**— If you have a net loss from U.S. sources in 1995, you must proportionately allocate that loss among the separate categories of your foreign income.

Reduce the income on line 14 by entering (in parentheses) on line 15 the allocable portion of any U.S. loss. A U.S. loss includes a rental loss on property located in the United States.

## Line 17

If you figured your tax using the Capital Gain Tax Worksheet in the Instructions for Form 1040, use the worksheet below to figure the amount to enter on line 17. An estate or trust that used the maximum 28% tax rate on capital gains should also complete the worksheet.

### Worksheet for Line 17

1. Enter the amount (net capital gain)\* from line 2 of the Capital Gain Tax Worksheet used to figure the tax for your return. Estates and trusts: Enter the amount from line 37a of Schedule D (Form 1041) ..... \_\_\_\_\_
2. Individuals: Enter the amount from Form 1040, line 35. Estates and trusts: Enter taxable income without the deduction for your exemption ... \_\_\_\_\_
3. Multiply line 1 by .2929 ..... \_\_\_\_\_
4. Subtract line 3 from line 2. Enter the result here and on Form 1116, line 17 ..... \_\_\_\_\_

\*Net capital gain does not include any amount that a taxpayer elects under section 163(d) to treat as investment income for purposes of the investment interest expense limitation.

## Part IV—Summary of Credits From Separate Parts III

Complete this part on only one Form 1116 to summarize the credits you figured on separate Forms 1116. Enter the credits from line 21 of the separate Forms 1116 on lines 22 through 29, as appropriate. File the other Forms 1116 as attachments.