

worksheet if it figured its tax using the maximum 28% tax rate on capital gains. For purposes of the worksheet, treat all numbers as positive amounts.

**Caution:** *If your capital gains or losses fall into two or more separate income categories (e.g., the passive category and the general limitation category), do not use the worksheet below. Instead, see Pub. 514 for information on how to report the amounts.*

### Worksheet for Capital Losses (Keep for your records.)

1. Enter your net capital loss from foreign sources (to the extent taken into account in determining capital gain net income).....
2. Enter net capital gain\* from sources within the United States. (This is the excess of net long-term capital gains from U.S. sources over net short-term capital losses from U.S. sources.) .....
3. Enter the amount (net capital gain)\* from line 2 of the Capital Gain Tax Worksheet you used to figure the tax for your return. (Estates and trusts should use line 37a of Schedule D (Form 1041).) .....
4. Subtract line 3 from line 2.....
5. Multiply line 4 by .2929 .....
6. Subtract line 5 from line 1. This is your net capital loss from foreign sources. Enter this amount here and on line 5 of Form 1116.....

\*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.

### High-Taxed Income

In some cases, passive income may be placed in the general limitation income category. Passive income may qualify as general limitation income if the foreign taxes you paid on the income (after allocation of expenses) exceed the highest U.S. tax that can be imposed on the income.

## Specific Instructions

### Part I—Taxable Income or Loss From Sources Outside the United States

#### Line 1

Include any income in the category checked above Part I that is taxable by the United States and that is from sources within the country entered on line j. You must include this income

even if it is not taxable by that country. Identify the type of income on the dotted line next to line 1. Do not include any earned income excluded on **Form 2555**, Foreign Earned Income. Use a separate Form 1116 for each category of income you are reporting.

**Example.** If you received dividends (passive income) and wages (general limitation income) from a foreign source, you must complete two Forms 1116. On one Form 1116, enter the dividends on line 1 and write "Dividends" on the dotted line. On the other Form 1116, enter wages (not excluded on Form 2555) on line 1 and write "Wages" on the dotted line. Complete Parts I, II and III of each Form 1116. Then, complete the summary Part IV of one Form 1116.

**Note:** *If you are reporting income from a partnership or an S corporation, include on line 1 any amount from line 17c, Schedule K-1 (Form 1065) or from line 15c, Schedule K-1 (Form 1120S).*

### Allocating Deductions

You must reduce your foreign gross income on line 1 by entering on lines 2 through 5:

- Any deductions you are taking that directly relate to that foreign income AND
- A ratable share of your other deductions that do not directly relate to either your foreign income on line 1 or your U.S. source income.

Do not include deductions and losses related to exempt or excluded income such as foreign earned income excluded on Form 2555. Do not include the deduction for personal exemptions.

Special rules apply to the allocation of research and experimental expenditures. See section 864(f).

If the law of a U.S. state to which you pay income taxes does not specifically exempt foreign source income from tax, you may be required to make a special allocation of state taxes you paid. See Pub. 514.

**Itemized deduction limit.**— If you are required to reduce the total amount of your itemized deductions on Schedule A (Form 1040), line 28, because your adjusted gross income was more than \$114,700 (\$57,350 if married filing separately), you must reduce each of the itemized deductions on Schedule A that are subject to the reduction by the reduction percentage before you

complete lines 2, 3a, and 4 on Form 1116.

Use the **Itemized Deductions Worksheet** in the Instructions for Schedule A (Form 1040) to figure the reduction percentage. Divide the amount on line 9 of the worksheet (the overall reduction) by the amount on line 3 of the worksheet (total itemized deductions subject to the reduction). This is your reduction percentage. Apply the reduction percentage to each itemized deduction to determine the amount to enter on the appropriate line of Form 1116.

**Example.** You are single and have an adjusted gross income of \$164,700. Your itemized deductions subject to the overall reduction (line 3 of the worksheet) total \$20,000. This amount includes a deduction for gifts to charity of \$12,000. The other \$8,000 (\$20,000 – \$12,000) of itemized deductions are directly allocable to the income on Form 1116, line 1.

The amount of the overall reduction on line 9 of the worksheet is \$1,500. To figure the amount of the charitable deduction to include in the total for line 3a of Form 1116, divide the amount on line 9 (\$1,500) by the amount on line 3 (\$20,000). This is your reduction percentage (7.5%). You must reduce your \$12,000 deduction by \$900 (7.5% × \$12,000). The reduced deduction, \$11,100 (\$12,000 – \$900) is the amount to include in the total for line 3a. Make a similar computation to figure the amount of directly allocable itemized deductions to enter on line 2 of Form 1116.

**Note:** *If you were required to reduce your itemized deductions on Schedule A, you do not need to make the computation described under **Itemized deduction limit** above if the total amount of your itemized deductions is entered on any one of the following lines: line 2, line 3a, or line 4a. Simply enter your reduced itemized deductions on that line.*

#### Line 2

**Caution:** *Before you complete line 2, read **Itemized deduction limit** above.*

Enter all deductions that relate directly to the gross income from foreign sources shown on line 1. For example, if you are an employee reporting foreign earned income on Form 1116, line 2 may include expenses such as those incurred to