

902. Deemed paid credit where domestic corporation owns 10 percent or more of voting stock of foreign corporation

(a) Taxes paid by foreign corporation treated as paid by domestic corporation. -- For purposes of this subpart, a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of such foreign corporation's post-1986 foreign income taxes as --

(1) the amount of such dividends (determined without regard to section 78), bears to

(2) such foreign corporation's post -1986 undistributed earnings.

(b) Deemed taxes increased in case of certain 2nd and 3rd tier foreign corporations. --

(1) 2nd tier. -- If the foreign corporation described in subsection (a) (hereinafter in this section referred to as the "1st tier corporation") owns 10 percent or more of the voting stock of a 2nd foreign corporation from which it receives dividends in any taxable year, the 1st tier corporation shall be deemed to have paid the same proportion of such 2nd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 1st tier corporation were a domestic corporation.

(2) 3rd tier. -- If such 1st tier corporation owns 10 percent or more of the voting stock of a 2nd foreign corporation which, in turn, owns 10 percent or more of the voting stock of a 3rd foreign corporation from which the 2nd corporation received dividends in any taxable year, such 2nd foreign corporation shall be deemed to have paid the same proportion of such 3rd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 2nd foreign corporation were a domestic corporation.

(3) 5 percent stock requirement. -- For purposes of this subject --

(A) For 2nd tier. -- Paragraph (1) shall not apply unless the percentage of voting stock owned by the domestic corporation in the 1st tier corporation and the percentage of voting stock owned by the 1st tier corporation in the 2nd foreign corporation when multiplied together equal at least 5 percent.

(B) For 3rd tier. -- Paragraph (2) shall not apply unless the percentage arrived at for purposes of applying paragraph (1) when multiplied by the percentage of voting stock owned by the 2nd foreign corporation in the 3rd foreign corporation is equal to at least 5 percent.

(c) Definitions and special rules. -- For purposes of this section --

(1) Post-1986 undistributed earnings. -- The term "post-1986 foreign corporation (computed in accordance with section 964 (a) and 986) accumulated in taxable years beginning after December 31, 1986 --

(A) as of the close of the taxable year of the foreign corporation in which the dividend is distributed, and

(B) without diminution by reason of dividends distributed during such taxable year.

(2) Post-1986 foreign income taxes. -- The term "post-1986 foreign income taxes" means the sum of --

(A) the foreign income taxes with respect to the taxable year of the foreign corporation in which the dividend is distributed, and

(B) the foreign income taxes with respect to prior taxable years beginning after December 31, 1986, to the extent such foreign taxes were not deemed paid with respect to dividends distributed by the foreign corporation in prior taxable years.

(3) Special rule where domestic corporation acquires 10 percent of foreign corporation after December 31, 1986. --

(A) In general. -- If the 1st day on which the ownership requirements of subparagraph (b) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 foreign income taxes of such foreign corporation shall be determined by taking into account only periods beginning on and after the 1st day of the 1st taxable year in which such ownership requirements are met.

(B) Ownership requirements. -- The ownership requirements of this subparagraph are met with respect to any foreign corporation if --

(i) 10 percent or more of the voting stock of such foreign corporation is owned by a domestic corporation,

(ii) the requirements of subsection (b)(3)(A) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (i), or

(iii) the requirements of subsection (b)(3)(B) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (ii).

(4) Foreign income taxes. --

(A) In general. -- The term "foreign income taxes" means any income, war profits, or excess profits taxes paid by the foreign corporation to any foreign country or possession of the United States.

(B) Treatment of deemed taxes. -- Except for purposes of determining the amount of the post-1986 foreign income taxes of a 3rd foreign corporation referred to in subsection (b)(2), the term "foreign income taxes" includes any such taxes deemed to be paid by the foreign corporation under this section.

(5) Accounting periods. -- In the case of a foreign corporation the income, war profits, and excess profits taxes of which are determined on the basis of an accounting period of less than 1 year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(6) Treatment of distributions from earnings before 1987. -

(A) In general. -- In the case of any dividend paid by a foreign corporation out of accumulated profits (as defined in this section as in effect on the day before the date of the

enactment of the Tax Reform Act of 1986) for taxable years beginning before the 1st taxable year taken into account in determining the post-1986 undistributed earnings of such corporation --

(i) this section (as amended by the Tax Refort Act of 1986) shall not apply, but

(ii) this section (as in effect on the day before the date of the enactment of such Act) shall apply.

(B) Dividends paid first out of post-1986 earnings. -- Any dividend in a taxable year beginning after December 31, 1986, shall be treated as made out of post-1986 undistributed earnings to the extent thereof.

(7) Regulations. -- The Secretary shall provide such regulations as may be necessary or appropriate to arry out the provisions of this section and section 960, including provisions which provide for the separate appliation of this section and section 960 to reflect the separate applciation of section 904 to separate types of income and loss.

(d) Cross references. --

(1) For inclusion in gross income of an amount equal to taxes deemed paid under subsection (a), see section 78.

(2) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxalbe year by a United States shareholder with respect to a controlled foreign corporation, see section 960.

(3) For reduction of credit with respect to dividends paid out of post-1986 undistributed earnings for years for which certain information is not furnished, see section 6038.

#### 903. Credit for taxes in lieu of income, etc., taxes

For purposes of this part and of sections 164(a) and 275(a), the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

#### 904. Limitation on credit

(a) Limitation. -- The total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources wihtout the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(b) Taxable incime for purpose of computing limitation. --

(1) Personal exemptions. -- For purposes of subsection (a), the taxable income in the case of an individual, estate, or trust shall be computed without any deduction for personal exemptions under section 151 or 642(b).

(2) Capital gains. -- For purposes of this section --

(A) In general. -- Taxable income from sources outside the United Sttes shall include gain from the sale or exchange of capital assets only to the extent of foreing source capital gain net income.

(B) Special rules where capital gain rate differential. -- In the case of any taxable year for which there is a capital gain rate differential --

(i) in lieu of applying subparagraph (A), the taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only in an amount equal to foreign source capital gain net income reduced by the rate differential portion of foreign source net capital gain,

(ii) the entire taxable income shall include gain from the sale or exchange of capital assets only in an amount equal to capital gain net income reduced by the rate differential portion of net capital gain, and

(iii) for purposes of determining taxable income from sources outside the United States, any net capital loss (and any amount which is a short-term capital loss under section 1212(a)) from sources outside the United States to the extent taken into account in determining capital gain net income for the taxable year shall be reduced by an amount equal to the rate differential portion of the excess of net capital gain from sources within the United States over net capital gain.

(3) Definitions. -- For purposes of this subsection --

(A) Foreign source capital gain net income. -- The term "foreign source capital gain net income" means the lesser of --

(i) capital gain net income from sources without the United States, or

(ii) capital gain net income.

(B) Foreign source net capital gain. -- The term "foreign source net capital gain" means the lesser of --

(i) net capital gain from sources without the United States, or

(ii) net capital gain.

(C) Section 1231 gains. -- The term "gain from the sale or exchange of capital assets" includes any gain so treated under section 1231.

(D) Capital gain rate differential. -- There is a capital gain rate differential for any taxable year if --

(i) in the case of a taxpayer other than a corporation, subsection (h) of section 1 applies to such taxable year, or

(ii) in the case of a corporation, any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever applies) exceeds the alternative rate of tax under section 1201(a) (determined without regard to the last sentence of section 11(b)(1)).

(E) Rate differential portion. --

(i) In general. -- The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as --

(I) the excess of the highest applicable tax rate over the alternative tax rate, bears to

(II) the highest applicable tax rate.

(ii) Highest applicable tax rate. -- For purposes of clause (i), the term "highest applicable tax rate" means --

(I) in the case of a taxpayer other than a corporation, the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies), or

(II) in the case of a corporation, the highest rate of tax specified in section 11(b).

(iii) Alternative tax rate. -- For purposes of clause (i), the term "alternative tax rate" means --

(I) in the case of a taxpayer other than a corporation, the alternative rate of tax determined under section 1(h), or

(II) in the case of a corporation, the alternative rate of tax under section 1201(a).

(4) Coordination with section 936. -- For purposes of subsection (a), in the case of a corporation, the taxable income shall not include any portion thereof taken into account for purposes of the credit (if any) allowed by section 936.

(c) Carryback and carryover of excess tax paid. -- Any amount by which all taxes paid or accrued to foreign countries or possessions of the United States for any taxable year for which the taxpayer chooses to have the benefits of this subpart exceed the limitation under subsection (a) shall be deemed taxes paid or accrued to foreign countries or possessions of the United States in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable years, in that order and to the extent not deemed taxes paid or accrued in a prior taxable year, in the amount by which the limitation under subsection (a) for such preceding or succeeding taxable year and the amount of the taxes for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as a deduction and only if the taxpayer for such year chooses to have benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions of the United States.

(d) Separate application of section with respect to certain categories of income. --

(1) In general. -- The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to each of the following items of income:

- (A) passive income,
- (B) high withholding tax interest,
- (C) financial services income,
- (D) shipping income,

(E) in the case of a corporation, dividends from each noncontrolled section 902 corporation,

(F) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States,

(G) taxable income attributable to foreign trade income (within the meaning of section 923(b)),

(H) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within

the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923 (b)) and

(I) income other than income described in any of the preceding subparagraphs.

(2) Definitions and special rules. -- For purposes of this subsection --

(A) Passive income. --

(i) In general. -- Except as otherwise provided in this subparagraph, the term "passive income" means any income received or accrued by any person which is of a kind which would be foreign personal holding company income (as defined in section 954(c)).

(ii) Certain amounts included. -- Except as provided in clause (iii), the term "passive income" includes any amount includible in gross income under section 551 or, except as provided in subparagraph (E)(iii) or paragraph (3)(I), section 1293 (relating to certain passive foreign investment companies).

(iii) Exceptions. -- The term "passive income" shall not include --

(I) any income described in a subparagraph of paragraph (1) other than subparagraph (A),

(II) any export financing interest,

(III) any high-taxed income, and

(IV) any foreign oil and gas extraction income (as defined in section 907(c)).

(iv) Clarification of application of section 864(d)(6). -- In determining whether any income is of a kind which would be foreign personal holding company income, the rules of section 864 (d)(6) shall apply only in the case of income of a controlled foreign corporation.

(B) High withholding tax interest. --

(i) In general. -- Except as otherwise provided in this subparagraph, the term "high" withholding tax interest" means any interest if --

(I) such interest is subject to a withholding tax of a foreign country or possession of the United States (or other tax determined on a gross basis), and

(II) the rate of such tax applicable to such interest is at least 5 percent.

(ii) Exception for export financing. -- The term "high withholding tax interest" shall not include any export financing interest.

(iii) Regulations. -- The Secretary may by regulations provide that --

(I) amounts (not otherwise high withholding tax interest) shall be treated as high withholding tax interest where necessary to prevent avoidance of the purposes of this subparagraph, and

(II) a tax shall not be treated as a withholding tax or other tax imposed on a gross basis if such tax is in the nature of a prepayment of a tax imposed on a net basis.

(C) Financial services income. --

(i) In general. -- Except as otherwise provided in this subparagraph, the term "financial services income" means any income which is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, and which is --

(I) described in clause (ii),

(II) passive income (determined without regard to subclause (I) of subparagraph (A)(iii)), or

(III) export financing interest which (but for subparagraph (B)(ii)) would be high withholding tax interest.

(ii) General description of financial services income. -- Income is described in this clause if such income is --

(I) derived in the active conduct of a banking, financing, or similar business,

(II) derived from the investment by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business, or

(III) of a kind which would be insurance income as defined in section 953(a) determined without regard to those provisions of paragraph (1)(A) of such section which limit insurance income to income from countries other than the country in which the corporation was created or organized.

(iii) Exceptions. -- The term "financial services income" does not include --

(I) any high withholding tax interest,

(II) any dividend from a noncontrolled section 902 corporation, and

(III) any export financing interest not described in clause (i)(III).

(D) Shipping income. -- The term "shipping income" means any income received or accrued by any person which is of a kind which would be foreign base company shipping income (as defined in section 954(f)). Such term does not include any dividend from a noncontrolled section 902 corporation and does not include any financial services income.

(E) Noncontrolled section 902 corporation. --

(i) In general. -- The term "noncontrolled section 902 corporation" means any foreign corporation with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraph (3), the requirements of section 902(b)). A controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for period during which it was a controlled foreign corporation and except as provided in regulations, the taxpayer was a United States shareholder in such corporation.

(ii) Special rule for taxes on high-withholding tax interest. -- If a foreign corporation is a noncontrolled section 902 corporation with respect to the taxpayer, taxes on high withholding tax interest (to the extent imposed at a rate in excess of 5 percent) shall not be treated as foreign taxes for purposes of determining the amount of foreign taxes deemed paid by the taxpayer under section 902.

(iii) Treatment of inclusion under section 1293. -- If any foreign corporation is a noncontrolled section 902 corporation with respect to the taxpayer, any inclusion under section 1293 with respect to such corporation shall be treated as a dividend from such corporation.

(F) High-taxed income. -- The term "high-taxed income" means any income which (but for this subparagraph) would be passive income if the sum of --

(i) the foreign income taxes paid or accrued by the taxpayer with respect to such income, and

(ii) the foreign income taxes deemed paid by the taxpayer with respect to such income under section 902 or 960, exceeds the highest rate of tax specified in section 1 or 11 (whichever applies) multiplied by the amount of such income (determined with regard to section 78). For purposes of the preceding sentence, the term "foreign income taxes" means any income war profits, or excess profits tax imposed by any foreign country or possession of the United States.

(G) Export financing interest. -- For purposes of this paragraph, the term "export financing interest" means any interest derived from financing the sale (or other disposition) for use or consumption outside the United States of any property --

(i) which is manufactured, produced, grown, or extracted in the United States by the taxpayer or a related person, and

(ii) not more than 50 percent of the fair market value of which is attributable to products imported into the United States.

For purposes of clause (ii), the fair market value of any property imported into the United States shall be its appraised value, as determined by the Secretary under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401a) in connection with its importation.

(H) Related person. -- For purposes of this paragraph, the term "related person" has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting "the person with respect to whom the determination is being made" for "controlled foreign corporation" each place it appears.

(I) Transitional rule. -- For purposes of paragraph (1) -

(i) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income which was described in subparagraph (A) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to income described in subparagraph (A) of paragraph (1) (as in effect after such date),

(ii) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income which was described in subparagraph (E) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to

income described in subparagraph (I) of paragraph (1) (as in effect after such date) except that --

(I) such taxes shall be treated as paid or accrued with respect to shipping income to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income,

(II) in the case of a person described in subparagraph (C) (i), such taxes shall be treated as paid or accrued with respect to financial services income to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income, and

(III) such taxes shall be treated as paid or accrued with respect to high withholding tax interest to the extent the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to such income, and

(iii) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income described in any other subparagraph of paragraph (1) (as so in effect before such date) shall be treated as taxes paid or accrued with respect to income described in the corresponding subparagraph of paragraph (1) (as so in effect after such date).

(3) Look-thru in case of controlled foreign corporations. -

(A) In general. -- Except as otherwise provided in this paragraph, dividends, interest, rents, and royalties received or accrued by the taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall not be treated as income in a separate category.

(B) Subpart F inclusions. -- Any amount included in gross income under section 951(a)(1)(A) shall be treated as income in a separate category to the extent the amount so included is attributable to income in such category.

(C) Interest, rents, and royalties. -- Any interest, rent, or royalty which is received or accrued from a controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as income in a separate category to the extent it is properly allocable (under regulations prescribed by the Secretary) to income of the controlled foreign corporation in such category.

(D) Dividends. -- Any dividend paid out of the earnings and profits of any controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as income in a separate category in proportion to the ratio of --

(i) the portion of the earnings and profits attributable to income in such category, to

(ii) the total amount of earnings and profits.

(E) Look-thru applies only where subpart F applies. -- If a controlled foreign corporation meets the requirements of section 954(b)(3)(A) (relating to de minimis rule) for any taxable year, for purposes of this paragraph, none of its foreign base company income (as defined in section 954(a) without regard to section 954(b)(5)) and none of its gross insurance income (as defined in section 954(b)(3)(C)) for such taxable year shall be treated as income in a separate category, except that this sentence shall

not apply to any income which (without regard to this sentence) would be treated as financial services income. Solely for purposes of applying subparagraph (D), passive income of a controlled foreign corporation shall not be treated as income in a separate category if the requirements of section 954(b)(4) are met with respect to such income.

(F) Separate category. -- For purposes of this paragraph -

(i) In general. -- Except as provided in clause (ii), the term "separate category" means any category of income described in subparagraph (A), (B), (C), (D), or (E) of paragraph (1).

(ii) Coordination with high-taxed income provisions. --

(I) In determining whether any income of a controlled foreign corporation is in a separate category, subclause (III) of paragraph (2)(A)(iii) shall not apply.

(II) Any income of the taxpayer which is treated as income in a separate category under this paragraph shall be so treated notwithstanding any provision of paragraph (2); except that the determination of whether any amount is high-taxed income shall be made after the application of this paragraph.

(G) Dividend. -- For purposes of this paragraph, the term "dividend" includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

(H) Exception for certain high withholding tax interest. -- This paragraph shall not apply to any amount which --

(i) without regard to this paragraph, is high withholding tax interest (including any amount treated as high withholding tax interest under paragraph (2)(B)(iii)), and

(ii) would (but for this subparagraph) be treated as financial services income under this paragraph.

The amount to which this paragraph does not apply by reason of the preceding sentence shall not exceed the interest or equivalent income of the controlled foreign corporation taken into account in determining financial services income without regard to this subparagraph.

(I) Look-thru applies to passive foreign investment company inclusion. -- If --

(i) a passive foreign investment company is a controlled foreign corporation, and

(ii) the taxpayer is a United States shareholder in such controlled foreign corporation, any amount included in gross income under section 1293 shall be treated as income in a separate category to the extent such amount is attributable to income in such category.

(4) Controlled foreign corporation; United States shareholder. -- For purposes of this subsection --

(A) Controlled foreign corporation. -- The term "controlled foreign corporation" has the meaning given such term by section 957 (taking into account section 953(c)).

(5) Regulations. -- The Secretary shall prescribe such regulations as may be necessary or appropriate for the purposes of this subsection, including regulations --

(A) for the application of paragraph (3) and subsection (f) (5) in the case of income paid (or loans made) through 1 or more entities or between 2 or more chains of entities,

(B) preventing the manipulation of the character of income the effect of which is to avoid the purposes of this subsection, and

(C) providing that rules similar to the rules of paragraph (3)(C) shall apply to interest, rents, and royalties received or accrued from entities which would be controlled foreign corporations if they were foreign corporations.

(e) Repealed.

(f) Recapture of overall foreign loss. --

(1) General rule. -- For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall foreign loss for any taxable year, that portion of the taxpayer's taxable income from sources without the United States for each succeeding taxable year which is equal to the lesser of --

(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

(B) 50 percent (or such larger percent as the taxpayer may choose) of the taxpayer's taxable income from sources without the United States for such succeeding taxable year, shall be treated as income from sources within the United States (and not as income from sources without the United States).

(2) Overall foreign loss defined. -- For purposes of this subsection, the term "overall foreign loss" means the amount by which the gross income for the taxable year from sources without the United States (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) for such year is exceeded by the sum of the deductions properly apportioned or allocated thereto, except that there shall not be taken into account --

(A) any net operating loss deduction allowable for such year under section 172(a), and

(B) any --

(i) foreign expropriation loss for such year, as defined in section 172(h), or

(ii) loss for such year which arises from fire, storm, shipwreck, or other casualty, or from theft, to the extent such loss is not compensated for by insurance or otherwise.

(3) Dispositions. --

(A) In general. -- For purposes of this chapter, if property which has been used predominantly without the United States in a trade or business is disposed of during any taxable year --

(i) the taxpayer, notwithstanding any other provision of this chapter (other than paragraph (1)), shall be deemed to have received and recognized taxable income from sources without the United States in the taxable year of the disposition, by reason of such disposition, in an amount equal to the lesser of the excess

of the fair market value of such property over the taxpayer's adjusted basis in such property or the remaining amount of the overall foreign losses which were not used under paragraph (1) for such taxable year or any prior taxable year, and

(ii) paragraph (1) shall be applied with respect to such income by substituting "100 percent" for "50 percent".

In determining for purposes of this subparagraph whether the predominant use of any property has been without the United States, there shall be taken into account use during the 3-year period ending on the date of the disposition (or, if shorter, the period during which the property has been used in the trade or business).

(B) Disposition defined and special rules. --

(i) For purposes of this subsection, the term "disposition" includes a sale, exchange, distribution, or gift of property whether or not gain or loss is recognized on the transfer.

(ii) Any taxable income recognized solely by reason of subparagraph (A) shall have the same characterization it would have had if the taxpayer had sold or exchanged the property.

(iii) The Secretary shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect taxable income recognized solely by reason of subparagraph (A).

(C) Exceptions. -- Notwithstanding subparagraph (B), the term "disposition" does not include --

(i) a disposition of property which is not a material factor in the realization of income by the taxpayer, or

(ii) a disposition of property to a domestic corporation in a distribution or transfer described in section 381(a).

(4) Accumulation distributions of foreign trust. -- For purposes of this chapter, in the case of amounts of income from sources without the United States which are treated under section 666 (without regard to subsections (b) and (c) thereof if the taxpayer chose to take a deduction with respect to the amounts described in such subsections under section 667(d)(1)(B)) as having been distributed by a foreign trust in a preceding taxable year, that portion of such amounts equal to the amount of any overall foreign loss sustained by the beneficiary in a year prior to the taxable year of the beneficiary in which such distribution is received from the trust shall be treated as income from sources within the United States (and not income from sources without the United States) to the extent that such loss was not used under this subsection in prior taxable years, or in the current taxable year, against other income of the beneficiary.

(5) Treatment of separate limitation losses. --

(A) In general. The amount of the separate limitation losses for any taxable year shall reduce income from sources within the United States for such taxable year only to the extent the aggregate amount of such losses exceeds the aggregate amount of the separate limitation incomes for such taxable year.

(B) Allocation of losses. -- The separate limitation losses for any taxable year (to the extent such losses do not exceed the separate limitation incomes for such year) shall be allocated

among (and operate to reduce) such incomes on a proportionate basis.

(C) Recharacterization of subsequent income. -- If --

(i) a separate limitation loss from any income category (hereinafter in this subparagraph referred to as "the loss category") was allocated to income from any other category under subparagraph (B), and

(ii) the loss category has income for a subsequent taxable year, such income (to the extent it does not exceed the aggregate separate limitation losses from the loss category not previously recharacterized under this subparagraph) shall be recharacterized as income from such other category in proportion to the prior reductions under subparagraph (B) in such other category not previously taken into account under this subparagraph. Nothing in the preceding sentence shall be construed as recharacterizing any tax.

(D) Special rules for losses from sources in the United States. -- Any loss from sources in the United States for any taxable year (to the extent such loss does not exceed the separate limitation incomes from such year) shall be allocated amount (and operate to reduce) such incomes on a proportionate basis. This subparagraph shall be applied after subparagraph (B)

(E) Definitions. -- For purposes of this paragraph --

(i) Income category. -- The term "income category" means each separate category of income described in subsection (d)(1).

(ii) Separate limitation income. -- The term "separate limitation income" means, with respect to any income category, the taxable income from sources outside the United States, separately computed for such category.

(iii) Separate limitation loss. -- The term "separate limitation loss" means, with respect to any income category, the loss from such category determined under the principles of section 907(c)(4)(B).

(F) Dispositions. -- If any separate limitation laws for any taxable year is allocated against any separate limitation income for such taxable year except to the extent provided in regulations, rules similar to the rules of paragraph (3) shall apply to any disposition of property if gain from such disposition would be in the income category with respect to which there was such separate limitation loss.

(g) Source rules in case of United States-owned foreign corporations. --

(1) In general. -- The following amounts which are derived from a United States-owned foreign corporation and which would be treated as derived from sources outside the United States without regard to this subsection shall, for purposes of this section, be treated as derived from sources within the United States to the extent provided in this subsection:

(A) Any amount included in gross income under --

(i) section 951(a) (relating to amounts included in gross income of United States shareholders),

(ii) section 551 (relating to foreign personal holding company income taxed to United States shareholders), or

(iii) section 1293 (relating to current taxation of income from qualified funds).

(B) Interest.

(C) Dividends.

(2) Subpart F and foreign personal holding or passive foreign investment company inclusions. -- Any amount described in subparagraph (A) of paragraph (1) shall be treated as derived from sources within the United States to the extent such amount is attributable to income of the United States-owned foreign corporation from sources within the United States.

(3) Certain interest allocable to United States source income. -- Any interest which --

(A) is paid or accrued by a United States-owned foreign corporation during any taxable year,

(B) is paid or accrued to a United States shareholder (as defined in section 951(b)) or a related person (within the meaning of section 267(b)) to such a shareholder, and

(C) is properly allocable (under regulations prescribed by the Secretary) to income of such foreign corporation for the taxable year from sources within the United States, shall be treated as derived from sources within the United States.

(4) Dividends. --

(A) In general. -- The United States source ratio of any dividend paid or accrued by a United States-owned foreign corporation shall be treated as derived from sources within the United States.

(B) United States source ratio. -- For purposes of subparagraph (A), the term "United States source ratio" means, with respect to any dividend paid out of the earnings and profits for any taxable year, a fraction --

(i) the numerator of which is the portion of the earnings and profits for such taxable year from sources within the United States, and

(ii) the denominator of which is the total amount of earnings and profits for such taxable year.

(5) Exception where United States-owned foreign corporation has small amount of United States source income. -- Paragraph (3) shall not apply to interest paid or accrued during any taxable year (and paragraph (4) shall not apply to any dividends paid out of the earnings and profits for such taxable year) if --

(A) the United States-owned foreign corporation has earnings and profits for such taxable year, and

(B) less than 10 percent of such earnings and profits is attributable to sources within the United States.

For purposes of the preceding sentence, earnings and profits shall be determined without any reduction for interest described in paragraph (3) (determined without regard to subparagraph (C) thereof).

(6) United States-owned foreign corporation. -- For purposes of this subsection, the term "United States-owned foreign corporation" means any foreign corporation if 50 percent or more of --

(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(B) the total value of the stock of such corporation, is held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30)).

(7) Dividend. -- For purposes of this subsection, the term "dividend" includes any gain treated as ordinary income under section 1246 or as a dividend under section 1248.

(8) Coordination with subsection (f). -- This subsection shall be applied before subsection (f).

(9) Treatment of certain domestic corporations. -- For purposes of this subsection --

(A) in the case of interest treated as not from sources within the United States under section 861(a)(1)(A), the corporation paying such interest shall be treated as a United States-owned foreign corporation, and

(B) in the case of any dividend treated as not from sources within the United States under section 861(a)(2)(A), the corporation paying such dividend shall be treated as a United States-owned foreign corporation.

(10) Coordination with treaties. --

(A) In general. -- If --

(i) any amount derived from a United States-owned foreign corporation would be treated as derived from sources within the United States under this subsection by reason of an item of income of such United States-owned foreign corporation,

(ii) under a treaty obligation of the United States (applied without regard to this subsection and by treating any amount included in gross income under section 951(a)(1) as a dividend), such amount would be treated as arising from sources outside the United States, and

(iii) the taxpayer chooses the benefits of this paragraph, this subsection shall not apply to such amount to the extent attributable to such item of income (but subsections (a), (b), and (c) of this section and sections 902, 907, and 960 shall be applied separately with respect to such amount to the extent so attributable).

(B) Special rule. -- Amounts included in gross income under section 951(a)(1) shall be treated as a dividend under subparagraph (A)(iii) only if dividends paid by each corporation (the stock in which is taken into account in determining whether the shareholder is a United States shareholder in the United States-owned foreign corporation), if paid to the United States shareholder, would be treated under a treaty obligation of the United States as arising from sources outside the United States (applied without regard to this subsection).

(11) Regulations. -- The Secretary shall prescribe such regulations as may be necessary or appropriate for purposes of this subsection, including --

(A) regulations for the application of this subsection in the case of interest or dividend payments through 1 or more entities, and

(B) regulations providing that this subsection shall apply to interest paid or accrued to any person (whether or not a United States shareholder).

(h) Coordination with nonrefundable personal credits. -- In the case of an individual, for purposes of subsection (a), the tax against which the credit is taken in such tax reduced by the sum of the credits allowable under subpart A of part IV of subchapter A of this chapter.

(i) Limitation on Use of Deconsolidation to Avoid Foreign Tax Credit Limitations. -- If 2 or more domestic corporations would be members of the same affiliated group if --

(1) section 1504(b) were applied without regard to the exceptions contained therein, and

(2) the constructive ownership rules of section 1563(e) applied for purposes of section 1504(a), the Secretary may by regulations provide for resourcing the income of any of such corporations or for modifications to the consolidated return regulations to the extent that such resourcing or modifications are necessary to prevent the avoidance of the provisions of this subpart.

(j) Cross references. --

(1) For increase of limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(b).

(2) For modification of limitation under subsection (a) for purposes of determining the amount of credit which can be taken against the alternative minimum tax, see section 59(a).

#### 905. Applicable rules

(a) Year in which credit taken. -- The credits provided in this subpart may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c). If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken on the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(b) Proof of credits. -- The credits provided in this subpart shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary --

(1) the total amount of income derived from sources without the United States, determined as provided in part I,

(2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this subpart, such amount to be determined under regulations prescribed by the Secretary, and

(3) all other information necessary for the verification and computation of such credits.

(c) Adjustments on payment of accrued taxes. -- If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected. The amount of tax due on such redetermination, if any, shall be paid by the taxpayer on notice and demand by the Secretary, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (sec. 6511 and following). In the case of such a tax accrued but not paid, the Secretary, as a condition precedent to the allowance of this credit, may require the taxpayer to give a bond, with sureties satisfactory to and to be approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination; and the bond herein prescribed shall contain such further conditions as the Secretary may require. In such determination by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but not credit under this subpart, and no deduction under section 164 (relating to deduction for taxes) shall be allowed for any taxable year with respect to such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period.

#### 906. Nonresident alien individuals and foreign corporations

(a) Allowance of credit. -- A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

(b) Special rules. --

(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income from sources within the United States which would not be taxed by such foreign country or possession but for the fact that --

(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country of possession.

(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States.

(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation.

(5) No credit shall be allowed under this section for any income, war profits and excess profits taxes paid or accrued with respect to the foreign trade income (within the meaning of section 923(b)) of a FSC.

(6) For purposes of section 902, any income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued) to any foreign country of possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States shall not be taken into account, and any accumulated profits attributable to such income shall not be taken into account.

(7) No credit shall be allowed under this section against the tax imposed by section 884.

#### 907. Special rules in case of foreign oil and gas income

(a) Reduction in amount allowed as foreign tax under section 901. -- In applying section 901, the amount of any oil and gas extraction taxes paid or accrued (or deemed to have been paid) during the taxable year which would (but for this subsection) be taken into account for purposes of section 901 shall be reduced by the amount (if any) by which the amount of such taxes exceeds the product of --

(1) the amount of the foreign oil and gas extraction income for the taxable year,

(2) multiplied by --

(A) in the case of a corporation, the percentage which is equal to the highest rate of tax specified under section 11(b), or

(B) in the case of an individual, a fraction the numerator of which is the tax against which the credit under section 901 (a) is taken and the denominator of which is the taxpayer's entire taxable income.

(b) Foreign taxes on foreign oil related income. -- For purposes of this subtitle, in the case of taxes paid or accrued to any foreign country with respect to foreign oil, related income, the term "income, war profits, and excess profits taxes" shall not include any amount paid or accrued after December 31,

1982, to the extent that the Secretary determines that the foreign law imposing such amount of tax is structured, or in fact operate, so that the amount of tax imposed with respect to foreign oil related income will generally be materially greater, over a reasonable period of time, than the amount generally imposed on income that is neither foreign oil related income nor foreign oil and gas extraction income. In computing the amount not treated as tax under this subsection, such amount shall be treated as a deduction under the foreign law.

(c) Foreign income definitions and special rules. -- For purposes of this section --

(1) Foreign oil and gas extraction income. -- The term "foreign oil and gas extraction income" means the taxable income derived from sources without the United States and its possessions from --

(A) the extraction (by the taxpayer or any other person) of minerals from oil or gas wells, or

(B) the sale or exchange of assets used by the taxpayer in the trade or business described in subparagraph (A).

(2) Foreign oil related income. -- The term "foreign oil related income" means the taxable income derived from sources outside the United States and its possessions from --

(A) the processing of minerals extracted (by the taxpayer or by any other person) from oil or gas wells into their primary products,

(B) the transportation of such minerals or primary products,

(C) the distribution or sale of such minerals or primary products,

(D) the disposition of assets used by the taxpayer in the trade or business described in subparagraph (A), (B), or (C), or

(E) the performance of any other related service.

(3) Dividends, interest, partnership distribution, etc. -- The term "foreign oil and gas extraction income" and the term "foreign oil related income" include --

(A) dividends and interest from a foreign corporation in respect of which taxes are deemed paid by the taxpayer under section 902,

(B) amounts with respect to which taxes are deemed paid under section 960(a), and

(C) the taxpayer's distributive share of the income of partnerships.

to the extent such dividends, interest, amounts, or distributive share is attributable to foreign oil and gas extraction income, or to foreign oil related incomes, as the case may be; except that interest described in subparagraph (A) shall not be taken into account in computing foreign oil and gas extraction income but shall be taken into account in computing foreign oil-related income.

(4) Recapture of foreign oil and gas extraction losses by recharacterizing later extraction income. --

(A) In general. -- That portion of the income of the taxpayer for the taxable year which (but for this paragraph) would be treated as foreign oil and gas extraction income shall be

treated as income (from sources without the United States) which is not foreign oil and gas extraction income to the extent of the excess of --

(i) the aggregate amount of foreign oil extraction losses for preceding taxable years beginning after December 31, 1982, over

(ii) so much of such aggregate amount as was recharacterized under this subparagraph for preceding taxable years beginning after December 31, 1982.

(B) Foreign oil extraction loss defined. --

(i) In general. -- For purposes of this paragraph, the term "foreign oil extraction loss" means the amount by which --

(I) the gross income for the taxable year from sources without the United States and its possessions (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) taken into account in determining the foreign oil and gas extraction income for such year, is exceeded by

(II) the sum of the deductions properly apportioned or allocated thereto.

(ii) Net operating loss deduction not taken into account. -- For purposes of clause (i), the net operating loss deduction allowable for the taxable year under section 172(a) shall not be taken into account.

(iii) Expropriation and casualty losses not taken into account. --

For purposes of clause (i), there shall not be taken into account --

(I) any foreign expropriation loss (as defined in section 172(h)) for the taxable year, or

(II) any loss for the taxable year which arises from fire, storm, shipwreck, or other casualty, or from theft, to the extent such loss is not compensated for by insurance or otherwise.

(5) Oil and gas extraction taxes. -- The term "oil and gas extraction taxes" means any income, war profits, and excess profits taxes" means any income, war profits, and excess profits tax paid or accrued (or deemed to have been paid under section 902 or 960) during the taxable year with respect to foreign oil and gas extraction income (determined without regard to paragraph (4)) or loss which would be taken into account for purposes of section 901 without regard to this section.

(d) Disregard of certain posted prices, etc. -- For purposes of this chapter, in determining the amount of taxable income in the case of foreign oil and gas extraction income, if the oil or gas is disposed of, or is acquired other than from the government of a foreign country, at a posted price (or other pricing arrangement) which differs from the fair market value for such oil or gas, such fair market value shall be used in lieu of such posted price (or other pricing arrangement).

(e) Repealed.

(f) Carryback and carryover of disallowed credits. --

(1) In general. -- If the amount of the oil and gas extraction taxes paid or accrued during any taxable year exceeds the limitation provided by subsection (a) for such taxable year

(hereinafter in this subsection referred to as the "unused credit year"), such excess shall be deemed to be oil and gas extraction taxes paid or accrued in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable year, in that order and to the extent not deemed tax paid or accrued in a prior taxable year by reason of the limitation imposed by paragraph (2) . Such amount deemed paid or accrued in any taxable year may be availed of only as a tax credit and not as a deduction and only if the taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions. For purposes of this subsection, the terms "second preceding taxable year", and "first preceding taxable year" do not include any taxable year ending before January 1, 1975.

(2) Limitation. -- The amount of the unused oil and gas extraction taxes which under paragraph (1) may be deemed paid or accrued in any preceding or succeeding taxable year shall not exceed the lesser of --

(A) the amount by which the limitation provided by subsection (a) for such taxable year exceeds the sum of --

(i) the oil and gas extraction taxes paid or accrued during such taxable year, plus

(ii) the amounts of the oil and gas extraction taxes which by reason of this subsection are deemed paid or accrued in such taxable year and are attributable to taxable years preceding the unused credit year; or

(B) the amount by which the limitation provided by section 904 for such taxable year exceeds the sum of --

(i) the taxes paid or accrued (or deemed to have been paid under section 902 or 960) to all foreign countries and possessions of the United States during such taxable year,

(ii) the amount of such taxes which were deemed paid or accrued in such taxable year under section 904(c) and which are attributable to taxable years preceding the unused credit year, plus

(iii) the amount of the oil and gas extraction taxes which by reason of this subsection are deemed paid or accrued in such taxable year and are attributable to taxable years preceding the unused credit year.

(3) Special rules. --

(A) In the case of any taxable year which is an unused credit year under this subsection and which is an unused credit year under section 904(c), the provisions of this subsection shall be applied before section 904(c).

(B) For purposes of determining the amount of taxes paid or accrued in any taxable year which may be deemed paid or accrued in a preceding or succeeding taxable year under section 904(c), any tax deemed paid or accrued in such preceding or succeeding taxable year under this subsection shall be considered to be tax paid or accrued in such preceding or succeeding taxable year.

(C) Repealed.

908. Reduction of credit for participation in or cooperation with an international boycott

(a) In general. -- If a person, or a member of a controlled group (within the meaning of section 993(a)(3)) which includes such person, participates in or cooperates with an international boycott during the taxable year (within the meaning of section 999(b)), the amount of the credit allowable under section 901 to such person, or under section 902 or 960 to United States shareholders of such person, for foreign taxes paid during the taxable year shall be reduced by an amount equal to the product of --

(1) the amount of the credit which, but for this section, would be allowed under section 901 for the taxable year, multiplied by

(2) the international boycott factor (determined under section 999).

(b) Application with sections 275(a)(4) and 78. -- Section 275(a)(4) and section 78 shall not apply to any amount of taxes denied credit under subsection (a).

911. Citizens or residents of the United States living abroad

(a) Exclusion from gross income. -- At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year --

(1) the foreign earned income of such individual, and

(2) the housing cost amount of such individual.

(b) Foreign earned income. --

(1) Definitions. -- For purposes of this section --

(A) In general. -- The term "foreign earned income" with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

(B) Certain amounts not included in foreign earned income. -- The foreign earned income for an individual shall not include amounts --

(i) received as a pension or annuity,

(ii) paid by the United States or an agency thereof to an employee of the United States or an agency thereof,

(iii) included in gross income by reason of section 402(b) (relating to taxability of beneficiary on non-exempt trust) or section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or

(iv) received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

(2) Limitation on foreign earned income. --

(A) In general. -- The foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate of \$70,000.

(B) Attribution to year in which services are performed. -  
- For purposes of applying subparagraph (A), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

(C) Treatment of community income. -- In applying subparagraph (A) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount which may be excludable from the gross income of such husband and wife under subsection (a)(1) for any taxable year shall equal the amount which would be so excludable if such amounts did not constitute community income.

(c) Housing cost amount. -- For purposes of this section -

(1) In general. -- The term "housing cost amount" means an amount equal to the excess of --

(A) the housing expenses of an individual for the taxable year, over

(B) an amount equal to the product of --

(1) 16 percent of the salary (computed on a daily basis) of an employee of the United States who is compensated at a rate equal to the annual rate paid for step 1 of grade GS-14, multiplied by

(ii) the number of days of such taxable year within the applicable period described in subparagraph (A) or (B) of subsection (d)(1).

(2) Housing expenses. --

(A) In general. -- The term "housing expenses" means the reasonable expenses paid or incurred during the taxable year by or on behalf of an individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. The term --

(i) includes expenses attributable to the housing (such as utilities and insurance), but

(ii) does not include interest and taxes of the kind deductible under section 163 or 164 or any amount allowable as a deduction under section 216(a).

Housing expenses shall not be treated as reasonable to the extent such expenses are lavish or extravagant under the circumstances.

(B) Second foreign household. --

(i) In general. -- Except as provided in clause (ii), only housing expenses incurred with respect to that abode which bears the closest relationship to the tax home of the individual shall be taken into account under paragraph (1).

(ii) Separate household for spouse and dependents. -- If an individual maintains a separate abode outside the United States for his spouse and dependents and they do not reside with him because of living conditions which are dangerous, unhealthful, or otherwise adverse, then --

(I) the words "if they reside with him" in subparagraph (A) shall be disregarded, and

(II) the housing expenses incurred with respect to such abode shall be taken into account under paragraph (1).

(3) Special rules where housing expenses not provided by employer. --

(A) In general. -- To the extent the housing cost amount of any individual for any taxable year is not attributable to employer provided amounts, such amount shall be treated as a deduction allowable in computing adjusted gross income to the extent of the limitation of subparagraph (B).

(B) Limitation. -- For purposes of subparagraph (A), the limitation of this subparagraph is the excess of --

(i) the foreign earned income of the individual for the taxable year, over

(ii) the amount of such income excluded from gross income under subsection (a) for the taxable year.

(C) 1-year carryover of housing amounts not allowed by reason of subparagraph (B). --

(i) In general. -- The amount not allowable as a deduction for any taxable year under subparagraph (A) by reason of the limitation of subparagraph (B) shall be treated as a deduction allowable in computing adjusted gross income for the succeeding taxable year (and only for the succeeding taxable year) to the extent of the limitation of clause (ii) for such succeeding taxable year.

(ii) Limitation. -- For purposes of clause (i), the limitation of this clause for any taxable year is the excess of -

(I) the limitation of subparagraph (B) for such taxable year, over

(II) amounts treated as a deduction under subparagraph (A) for such taxable year.

(D) Employer provided amounts. -- For purposes of this paragraph, the term "employer provided amounts" means any amount paid or incurred on behalf of the individual by the individual's employer which is foreign earned income included in the individual's gross income for the taxable year (without regard to this section).

(E) Foreign earned income. -- For purposes of this paragraph, an individual's foreign earned income for any taxable year shall be determined without regard to the limitation of subparagraph (A) of subsection (b)(2).

(d) Definitions and special rules. -- For purposes of this section --

(1) Qualified individual. -- The term "qualified individual" means an individual whose tax home is in a foreign country and who is --

(A) a citizen of the United States and establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(B) a citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period.

(2) Earned income. --

(A) In general. -- The term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.

(B) Taxpayer engaged in trade or business. -- In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

(3) Tax home. -- The term "tax home" means, with respect to any individual, such individual's home for purposes of section 162(a)(2) (relating to traveling expenses while away from home). An individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States.

(4) Waiver of period of stay in foreign country. -- Notwithstanding paragraph (1), an individual who --

(A) is a bona fide resident of, or is present in, a foreign country for any period.

(B) leaves such foreign country after August 31, 1978 --

(i) during any period during which the Secretary determines, after consultation with the Secretary of State or his delegate, that individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions in such foreign country which precluded the normal conduct of business by such individuals, and

(ii) before meeting the requirements of such paragraph (1), and

(C) establishes to the satisfaction of the Secretary that such individual could reasonably have been expected to have met such requirements but for the conditions referred to in clause (i) of subparagraph (B), shall be treated as a qualified individual with respect to the period described in subparagraph (A) during which he was a bona fide resident of, or was present in, the foreign country, and in applying subsections (b)(2)(A) and (c)(1)(B)(ii) with respect to such individual, only the days within such period shall be taken into account.

(5) Test of bona fide residence. -- If --

(A) an individual who has earned income from sources within a foreign country submits a statement to the authorities of that country that he is not a resident of that country, and

(B) such individual is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings, then such individual shall not be considered a bona fide resident of that country for purposes of paragraph (1)(A).

(6) Denial of double benefits. -- No deduction or exclusion from gross income under this subtitle or credit against the tax imposed by this chapter (including any credit or deduction for the amount of taxes paid or accrued to a foreign country or possession of the United States) shall be allowed to the extent such deduction, exclusion, or credit is properly allocable to or chargeable against amounts excluded from gross income under subsection (a).

(7) Aggregate benefit cannot exceed foreign earned income. -- The sum of the amount excluded under subsection (a) and the amount deducted under subsection (c)(3)(A) for the taxable year shall not exceed the individual's foreign earned income for such year.

(8) Limitation on income earned in restricted country. --

(A) In general. -- If travel (or any transaction in connection with such travel) with respect to any foreign country is subject to the regulations described in subparagraph (B) during any period--

(i) the term "foreign earned income" shall not include any income from sources within such country attributable to services performed during such period,

(ii) the term "housing expenses" shall not include any expenses allocable to such period for housing in such country or for housing of the spouse or dependents of the taxpayer in another country while the taxpayer is present in such country, and

(iii) an individual shall not be treated as a bona fide resident of, or as present in, a foreign country for any day during which such individual was present in such country during such period.

(B) Regulations. -- For purposes of this paragraph, regulations are described in this subparagraph if such regulations --

(i) have been adopted pursuant to the Trading With the Enemy Act (50 U.S. C.App. 1 et seq.), or the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.), and

(ii) include provisions generally prohibiting citizens and residents of the United States from engaging in transactions related to travel to, from, or within a foreign country.

(C) Exception. -- Subparagraph (A) shall not apply to any individual during any period in which such individual's activities are not in violation of the regulations described in subparagraph (B).

(9) Regulations. -- The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing rules -

(A) for cases where a husband and wife each have earned income from sources outside the United States, and

(B) for married individuals filing separate returns.

(e) Election. --

(1) In general. -- An election under subsection (a) shall apply to the taxable year for which made and to all subsequent taxable years unless revoked under paragraph (2).

(2) Revocation. -- A taxpayer may revoke an election made under paragraph (1) for any taxable year after the taxable year for which such election was made. Except with the consent of the Secretary, any taxpayer who makes such a revocation for any taxable year may not make another election under this section for any subsequent taxable year before the 6th taxable year after the taxable year for which such revocation was made.

(f) Cross references. --

For administrative and penal provisions relating to the exclusions provided for in this section, see sections 6001, 6011, 6012(c), and the other provisions of subtitle F.

#### 912. Exemption for certain allowances

The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

(1) Foreign areas allowances. -- In the case of civilian officers and employees of the Government of the United States, amounts received as allowances or otherwise (but not amounts received as post differentials) under --

(A) chapter 9 of title I of the Foreign Service Act of 1980,

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(2) Cost-of-living allowances. -- In the case of civilian officers, or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President (or in the case of judicial officers or employees of the United States, in accordance with rules similar to such regulations).

(3) Peace Corps allowances. -- In the case of an individual who is a volunteer or volunteer leader within the meaning of the Peace Corps Act and members of his family, amounts received as allowances under section 5 or 6 of the Peace Corps act other than amounts received as --

(A) termination payments under section 5(c) or section 6 (1) of such Act,

(B) leave allowances,

(C) if such individual is a volunteer leader training in the United States, allowances to members of his family, and

(D) such portion of living allowances as the President may determine under the Peace Corps Act as constituting basic compensation.

#### 913. Repealed.

#### 921. Exempt foreign trade income excluded from gross income

(a) Exclusion. -- Exempt foreign trade income of a FSC shall be treated as foreign source income which is not effectively connected with the conduct of a trade or business within the United States.

(b) Proportionate allocation of deductions to exempt foreign trade income. -- Any deductions of the FSC properly apportioned and allocated to the foreign trade income derived by a FSC from any transaction shall be allocated between --

(1) the exempt foreign trade income derived from such transaction, and

(2) the foreign trade income (other than exempt foreign trade income) derived from such transactions, on a proportionate basis.

(c) Denial of credits. -- Notwithstanding any other provision of this chapter, no credit (other than a credit allowable under section 27(a), 33, or 34) shall be allowed under this chapter to any FSC.

(d) Foreign trade income, investment income, and carrying charges treated as effectively connected with United States business. -- For purposes of this chapter --

(1) all foreign trade income of a FSC other than --

(A) exempt foreign trade income, and

(B) section 923(a)(2) non-exempt income,

(2) all interest, dividends, royalties, and other investment income received or accrued by a FSC, and

(3) all carrying charges received or accrued by a FSC, shall be treated as income effectively connected with a trade or business conducted through a permanent establishment of such corporation within the United States. Income described in paragraph (1) shall be treated as derived from sources within the United States.

#### 922. FSC defined

(a) FSC defined. -- For purposes of this title, the term "FSC" means any corporation --

(1) which --

(A) was created or organized --

(i) under the laws of any foreign country which meets the requirements of section 927(e)(3), or

(ii) under the laws applicable to any possession of the United States,

(B) has no more than 25 shareholders at any time during the taxable year,

(C) does not have any preferred stock outstanding at any time during the taxable year.

(D) during the taxable year --

(i) maintains an office located outside the United States in a foreign country which meets the requirements of section 927(e)(3) or in any possession of the United States,

(ii) maintains a set of the permanent books of account (including invoices) of such corporation at such office, and

(iii) maintains at a location within the United States the records which such corporation is required to keep under section 6001,

(E) at all times during the taxable year, has a board of directors which includes at least one individual who is not a resident of the United States, and

(F) is not a member, at any time during the taxable year, of any controlled group of corporations of which a DISC is a member, and

(2) which has made an election (at the time and in the manner provided in section 927(f)(1)) which is in effect for the taxable year to be treated as a FSC.

(b) Small FSC defined. -- For purposes of this title, a FSC is a small FSC with respect to any taxable year if --

(1) such corporation has made an election (at the time and in the manner provided in section 927(f)(1)) which is in effect for the taxable year to be treated as a small FSC, and

(2) such corporation is not a member, at any time during the taxable year, of a controlled group of corporations which includes a FSC unless such other FSC has also made an election under paragraph (1) which is in effect for such year.

### 923. Exempt foreign trade income

(a) Exempt foreign trade income. -- For purposes of this subpart --

(1) In general. -- The term "exempt foreign trade income" means the aggregate amount of all foreign trade income of a FSC for the taxable year which is described in paragraph (2) or (3).

(2) Income determined without regard to administrative pricing rules. -- In the case of any transaction to which paragraph (3) does not apply, 43 percent of the foreign trade income derived from such transaction shall be treated as described in this paragraph. For purposes of the preceding sentence, foreign trade income shall not include any income property allocable to excluded property described in subparagraph (B) of section 927(a)(2) (relating to intangibles).

(3) Income determined with regard to administrative pricing rules. -- In the case of any transaction with respect to which paragraph (1) or (2) of section 925(a) (or the corresponding provisions of the regulations prescribed under section 925(b)) applies, 16/23 of the foreign trade income derived from such transaction shall be treated as described in this paragraph.

(4) Special rule for foreign trade income allocable to a cooperative. --

(A) In general. -- In any case in which a qualified cooperative is a shareholder of a FSC, paragraph (3) shall be applied with respect to that portion of the foreign trade income of such FSC for any taxable year which is properly allocable to the marketing of agricultural or horticultural products (or the providing of related services) by such cooperative by substituting "100 percent" for "16/23".

(B) Paragraph only to apply to amounts FSC distributes. -- Subparagraph (A) shall not apply for any taxable year unless the FSC distributes to the qualified cooperative the amount which (but for such subparagraph) would not be treated as exempt foreign trade income. Any distribution under this subparagraph for any taxable year --

(i) shall be made before the due date for filing the return of tax for such taxable year, but

(ii) shall be treated as made on the last day of such taxable year.

(5) Special rule for military property. -- Under regulations prescribed by the Secretary, that portion of the foreign trading gross receipts of the FSC for the taxable year attributable to the disposition of, or services relating to, military property (within the meaning of section 995(b)(3)(B)) which may be treated as exempt foreign trade income shall equal 50 percent of the amount which (but for this paragraph) would be treated as exempt foreign trade income.

(6) Cross reference. --

For reduction in amount of exempt foreign trade income, see section 291(a)(4).

(b) Foreign trade income defined. -- For purposes of this subpart, the term "foreign trade income" means the gross income of a FSC attributable to foreign trading gross receipts.