Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Process Unit

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Knowledge Base	International
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Book	Foreign Tax Credits Individual
Chapter	Calculation of Amount of Allowable FTC

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Process Overview

FTC Carryback and Carryover

Note: This practice unit was updated and supersedes the 03/23/2021, practice unit with the same title. The update provides some clarifying narrative as well as removing items of reference which are obsolete and removed.

A taxpayer who pays qualifying income taxes to a foreign country on income earned from abroad may claim those taxes as a deduction or a foreign tax credit (FTC) to mitigate the effect of double taxation. IRC 901. There is a limit on the FTC a taxpayer can take each year. The amount of a taxpayer's FTC is calculated as the lesser of the qualified foreign income taxes paid (or accrued), or the FTC limitation. The FTC limitation is an amount equal to the pre-credit U.S. tax on the taxpayer's foreign source income. Often a taxpayer cannot claim all the taxes as a credit which exceed the income tax limitation. A taxpayer in an excess credit position for a given year is allowed to carry over the excess of its foreign taxes paid or accrued for the year over the foreign tax credit limitation for the year. The carryback period is one year and carryforward is ten years. This practice unit will focus on FTC carrybacks and carryovers. Other aspects of how to calculate the FTC limitation or other FTC principles are addressed in other practice units referenced at end of this unit.

! **CAUTION:** The Tax Cuts & Jobs Act of 2017 (TCJA) created two new categories of income. While this practice unit will not cover the new tax law issues involved, carry rules in the passage of the TCJA apply for a new 951A category. Section 951A income, otherwise known as global intangible low-taxed income (GILTI), applies to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of the foreign corporation ends. IRC 904(c) disallows any carryover or carryback of FTC to or from the GILTI category. Form 1116 and related instructions associated with this new IRC 951A category of income and related taxes instruct the reader to leave the carryover/carryback line in Part III of Form 1116 blank.

'Excess limitation' is the amount by which the limitation exceeds the qualified taxes paid or accrued. The carryback or carryover tax years must have excess limitation to absorb the unused/excess taxes. Unused/excess foreign taxes are qualified foreign taxes paid or accrued that exceed the FTC limitation. Unused/excess taxes produce no benefit in the year they arise but may be carried back or forward.

Process Overview (cont'd)

FTC Carryback and Carryover

The unused/excess foreign taxes eligible to be carried back or forward are reported on Form 1116. Taxpayers claiming the benefit of a carryback or carryover of unused foreign tax to a taxable year in which they choose to claim an FTC, must complete Schedule B (Form 1116). For tax years prior to 2021, they must attach a statement with details showing the computations of unused foreign tax listed by year that is carried back or over.

Carrybacks and carryovers are figured separately for each separate category.

A period of less than 12 months for which the taxpayer makes a return is considered a tax year. Treas. Reg. 1.904-2(e).

<u>Example 1</u>

In 20X2, a cash basis taxpayer paid $1,000 in qualified foreign taxes for general category foreign income. The IRC 904(a) calculation limited the allowable credit to $700. The excess is $300 (taxes paid of $1,000 less limitation of general category income of $700). This excess represents the taxpayer's unused foreign taxes available for carryback and carryover. Therefore, the taxpayer has $300 to carryback one year and then forward ten years.

Tax Year	FTC Limitation	Foreign Taxes Paid (or accrued)	Excess Taxes (or Unused Foreign Taxes)(+)or Excess Limit (-)
20X2	$700	$1,000	$300

FTC Carryback and Carryover

Example 2

Expanding the facts from Example 1, in 20X1, the taxpayer has excess limitation of $200 (FTC limitation of $700 exceeds the available foreign taxes paid of $500). The 20X2 excess tax of $300 must be carried back first. The taxpayer is considered to have paid this unused foreign tax in 20X1 (the first preceding tax year) up to the 20X1 excess limitation in that year of $200. Since the carryback absorbed all the 20X1 excess limitation, the remaining $100 unused/excess taxes originating in 20X2 can be carried forward for ten consecutive years.

Tax Year	FTC Limitation	Foreign Taxes Paid (or accrued)	Excess Taxes (or Unused Foreign Taxes)(+)or Excess Limit (-)
20X1	$700	$500	($200)
20X2	$700	$1,000	$300

Note that just like the regular FTC, the AMT FTC is also limited. When this situation arises, the rules regarding the unused amounts are similar to the carryback and carryover requirements applicable to the regular FTC. AMT FTC carrybacks and carryforwards must also be accounted separately for each category of income.

The election to claim either the credit or deduction is an annual election. Therefore, based on circumstances, the taxpayer may elect to take a credit in one year and a deduction in another year. A taxpayer can only carry over excess credits if the taxpayer chooses to claim the FTC for the year in which the taxes were paid or accrued. There is no credit carryback or carryover to or from years in which taxes are deducted. IRC 904(c). Stated another way, if the taxpayer chooses to deduct foreign taxes for a year, they cannot generate excess foreign tax credits that can be carried over from that year. In cases where a deduction is taken, the taxpayer must treat any FTC carryback or carryover as if it was used in that year. Any unused foreign taxes that are eligible for carryback or carryover to a year that foreign taxes are deducted must be absorbed as though the taxpayer had elected to take the credit for foreign taxes paid in that year. The taxpayer must compute the FTC limitation for the year in which the taxpayer chose to deduct foreign taxes. If the taxpayer had excess limitation for that year, the excess limitation absorbs some, or all, of the carryover credit, even though the taxpayer chose to deduct taxes in that year. This reduces the amount of unused foreign taxes that can be carried to another year. In addition, a taxpayer cannot claim excess credits as foreign taxes paid or accrued in a carryover year unless the taxpayer chooses to credit foreign taxes in the carryover year.

Process Overview (cont'd)

FTC Carryback and Carryover

Example 3 - Treatment of Carryovers - Choosing Credit or Deduction

Tax Year	FTC Limitation	Foreign Taxes Paid (or accrued)	Excess Taxes (or Unused Foreign Taxes)(+)or Excess Limit (-)
20X1	$500	$700	($200)
20X2	$700	$600	($100)

Scenario 1: The taxpayer claims the credit for 20X2, and is allowed a credit of $700, consisting of $600 paid in 20X2 and $100 out of the $200 carried over from 20X1. This would result in a carryover to 20X3 of the remaining $100, the unused 20X1 FTC carryover.

Scenario 2: The taxpayer chooses to deduct foreign taxes in 20X2. The deduction will be limited to $600, which is the amount of taxes paid in 20X2. No deduction is allowed for any part of the carryover from 20X1. However, because there is an unused credit limit of $100 ($700 limit minus $600 of foreign taxes paid in 20X2), the taxpayer must treat $100 of the credit carryover as if it was used in 20X2. This reduces the carryover to later years.

If the taxpayer later decides to use the benefit of that $100 portion of the 20X1 carryover, an amended return can be filed for 20X2 to claim a credit, rather than a deduction. This can be done at any time during the period within 10 years from the regular due date for filing the return (without regard to any extension of time to file) for the tax year in which the taxes were actually paid or accrued.

Summary of Process Steps

FTC Carryback and Carryover
Process Steps
If, because of the limit on the FTC, the taxpayer cannot use the full amount of qualified foreign taxes paid or accrued in the tax year, the taxpayer is allowed a 1-year carryback and then a 10-year carryover of the unused foreign taxes, except in the Section 951A category.

Step 1	Determine FTC Excess Credit
Step 2	Determine FTC Excess Limitation
Step 3	Apply Ordering Rules for Carryback/Carryover

Step 1: Determine Excess Credit

FTC Carryback and Carryover
Step 1
Determine FTC Excess Credit.

Considerations	Resources
The taxpayer determines the amount of the creditable taxes paid or accrued during the tax year for each category of income involved. Where the taxpayer has paid or accrued more taxes in any category that is greater than the permitted credit, the taxpayer has generated an excess foreign tax credit in that category. ▪ Determine the qualified foreign taxes paid or accrued for each category of income. ▪ Determine the FTC limitation for the proper category of income. ▪ If the taxes paid/accrued exceed the limitation, there is excess credit. ▪ The year to which the excess credit can be carried must be a year which has excess limitation. ▪ Report carryovers by attaching Schedule B (Form 1116) beginning in tax year 2021-to reflect detailed unused foreign tax carried back or over.	▪ IRC 904 ▪ Treas. Reg 1.904-2(c)(1) ▪ Treas. Reg 1.904-2(f) ▪ Form 1040, U.S. Individual Income Tax Return ▪ Form 1116, Foreign Tax Credit (Individual, Estate, or Trust) ▪ Pub. 514, Foreign Tax Credit for Individuals

Step 2: Determine Excess Limitation

FTC Carryback and Carryover
Step 2
Determine FTC Excess Limitation.

Considerations	Resources
If a taxpayer's qualified taxes paid or accrued are less than the FTC limitation, an excess limitation occurs in that category. This excess limitation allows for utilization of carrybacks and carryovers. ▪ Determine the FTC limitation for the proper category of income. ▪ Determine the qualified foreign taxes paid or accrued for each category of income. ▪ If the FTC limitation exceeds the taxes paid, there is excess limitation available for other years of carryback/carryover. ▪ Report carryovers on Form 1116, line 10 (2023) and attach Schedule B (Form1116) for details of the unused foreign tax carried back or over.	▪ IRC 904 ▪ Treas. Reg 1.904-2(c)(3) ▪ Treas. Reg 1.904-2(f) ▪ Form 1040, U.S. Individual Income Tax Return ▪ Form 1116, Foreign Tax Credit (Individual, Estate, or Trust) ▪ Pub. 514, Foreign Tax Credit for Individuals

Step 3: Apply Carryback/Over Ordering Rules

FTC Carryback and Carryover
Step 3
Apply Ordering Rules for Carryback/Carryover.

Considerations	Resources
The FTC carryover rules are not elective (e.g. taxpayers cannot choose to forgo the carryback year and carry the excess credits forward). For each individual category of income: ▪ The taxpayer must use FTCs recognized in the current year first. ▪ Any unused FTCs resulting from the current year must be first carried back one year. ▪ Any unused FTCs must next be carried over 10 years in progressive order. ▪ When excess credits from different years are carried to the same year, taxes from earliest years are credited first. ▪ The amount of credit carried from year to year is reduced by credits actually used to offset U.S. taxes in the earlier years. ▪ If the excess credits from a particular tax year are not used as an FTC carryback in the first prior tax year or carryover in the 10 later years, the credits expire. This can occur when there isn't enough excess FTC limitation in the range of carry years to absorb the excess credits. ▪ If a taxpayer elects to deduct rather than take a credit for taxes paid or accrued when the taxpayer has a carryover, the amount of any tax credit carryover will be reduced by the amount that would have been credited if the taxpayer had elected to take the credit rather than deduct foreign taxes.	▪ IRC 904(c) ▪ Treas. Reg. 1.904-2(b) ▪ Treas. Reg. 1.904-2(d) ▪ Form 1040, U.S. Individual Income Tax Return ▪ Form 1116, Foreign Tax Credit (Individual, Estate, or Trust) ▪ Pub. 514, Foreign Tax Credit for Individuals

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Other Considerations / Impact to Audit

FTC Carryback and Carryover

Considerations	Resources
▪ Refund claims attributable to FTCs may be filed within 10 years of the expiration of the unextended due date of the return for the year the foreign taxes were paid or accrued. This applies only to claims based on FTCs, not foreign tax deductions.	▪ IRC 6511(d)(3)(A)
▪ Taxpayers claiming the benefit of a carryback or carryover must file a revised Schedule B (Form 1116) attached to an amended return.	▪ Treas. Reg. 1.904-2(f)
▪ Even with credit carryovers, if foreign income tax rates are persistently higher than U.S. rates, excess credits simply pile up and eventually expire unused, having provided no U.S. tax benefit.	
▪ If a taxpayer's debts are cancelled due to insolvency or bankruptcy, the taxpayer may need to reduce the unused carryovers to or from the tax year of debt cancellation. Also, the taxpayer may not be allowed to carry back any unused foreign tax to a year before the bankruptcy case began.	▪ Pub. 514, Foreign Tax Credit for Individuals ▪ Pub 908, Bankruptcy Tax Guide
▪ Foreign tax paid, accrued, or deemed paid under IRC 960 with respect to IRC 951A category income, including IRC 951A category income that is reassigned to a separate category for income resourced under a treaty, may not be carried back or carried forward or deemed paid or accrued under IRC 904(c).	▪ Treas. Reg. 1.904-2(a) ▪ Treas. Reg. 1.904-6(b)

Index of Referenced Resources

FTC Carryback and Carryover
Form 1040, U.S. Individual Income Tax Return
Form 1040 Instructions
Form 1116, Foreign Tax Credit (Individual, Estate or Trust)
Form 1116 Instructions
IRC 901
IRC 904
IRC 951A
IRC 960
IRC 6511
Pub. 514, Foreign Tax Credit for Individuals
Pub. 908, Bankruptcy Tax Guide
Treas. Reg. 1.904-2
Treas. Reg. 1.904-6

Training and Additional Resources

FTC Carryback and Carryover	
Type of Resource	**Description(s)**
Databases / Research Tools	▪ BNA Tax Management U.S. Int'l Portfolio 6060-1st Sec X ▪ Kuntz & Peroni - U.S. Int'l Tax Para B4.16

Glossary of Terms and Acronyms

Term/Acronym	Definition
AMT	Alternative Minimum Tax
FTC	Foreign Tax Credit
GILTI	Global Intangible Low-Taxed Income
IRC	Internal Revenue Code
TCJA	Tax Cuts & Jobs Act

Index of Related Practice Units

Associated UILs	Related Practice Unit
9432.01	FTC General Principles
9432.02	FTC Limitation and Computation