

Schedule J
(Form 1118)

(Rev. July 1994)

OMB No. 1545-0122

Separate Limitation Loss Allocations and Other Adjustments Necessary to Determine Numerators of Limitation Fractions, Year-End Recharacterization Balances, and Overall Foreign Loss Account Balances

For calendar year 19....., or other tax year beginning, 19....., and ending, 19.....
 ▶ Attach to Form 1118. For Paperwork Reduction Act Notice, see page 1 of Instructions for Form 1118.

Department of the Treasury
Internal Revenue Service

Employer identification number

Part I Adjustments to Separate Limitation Income or (Losses) in Determining Numerators of Limitation Fractions

	(i) General limitation income	(ii) Passive income	(iii) High withholding tax interest	(iv) Financial services income	(v) Shipping income	(vi) Dividends from a DISC or former DISC	(vii) Taxable income attributable to foreign trade income	(viii) Certain distributions from a FSC or former FSC	(ix) Dividends from noncontrolled section 902 corporation*
1 Separate limitation income or (loss) before adjustments (See instructions).									
2 Allocation of current year separate limitation losses (See instructions):									
a General limitation income	()	()	()	()	()	()	()	()	()
b Passive income	()	()	()	()	()	()	()	()	()
c High withholding tax interest	()	()	()	()	()	()	()	()	()
d Financial services income	()	()	()	()	()	()	()	()	()
e Shipping income	()	()	()	()	()	()	()	()	()
f Dividends from a DISC or former DISC	()	()	()	()	()	()	()	()	()
g Taxable income attributable to foreign trade income	()	()	()	()	()	()	()	()	()
h Certain distributions from a FSC or former FSC	()	()	()	()	()	()	()	()	()
i Dividends from noncontrolled section 902 corporation*	()	()	()	()	()	()	()	()	()
3 Subtotal —Combine lines 1 through 2i:									
4 Overall foreign losses									
5 Recapture of overall foreign losses									
6 Subtotal —Subtract line 5 from line 3.									
7 Recharacterization of separate limitation income (See instructions):									
a General limitation income	()	()	()	()	()	()	()	()	()
b Passive income	()	()	()	()	()	()	()	()	()
c High withholding tax interest	()	()	()	()	()	()	()	()	()
d Financial services income	()	()	()	()	()	()	()	()	()
e Shipping income	()	()	()	()	()	()	()	()	()
f Dividends from a DISC or former DISC	()	()	()	()	()	()	()	()	()
g Taxable income attributable to foreign trade income	()	()	()	()	()	()	()	()	()
h Certain distributions from a FSC or former FSC	()	()	()	()	()	()	()	()	()
i Dividends from noncontrolled section 902 corporation*	()	()	()	()	()	()	()	()	()
8 Subtotal —Combine lines 6 through 7i:									

* Important: If the corporation received dividends from more than one noncontrolled section 902 corporation, see General Instructions.

	(i) General limitation income	(ii) Passive income	(iii) High withholding tax interest	(iv) Financial services income	(v) Shipping income	(vi) Dividends from a DISC or former DISC	(vii) Taxable income attributable to foreign trade income	(viii) Certain distributions from a FSC or former FSC	(ix) Dividends from noncontrolled section 902 corporation*
9 Subtotal —Enter amounts from Part I, line 8									
10 Allocation of current year U.S. source losses (see instructions)									
11 Numerator of Limitation Fraction —Subtract line 10 from line 9. Enter each result here and on Part II, line 6, of corresponding Schedule B.									

Part II Year-End Balances of Future Separate Limitation Income That Must Be Recharacterized

a General limitation income									
b Passive income									
c High withholding tax interest									
d Financial services income									
e Shipping income									
f Dividends from a DISC or former DISC									
g Taxable income attributable to foreign trade income									
h Certain distributions from a FSC or former FSC									
i Dividends from noncontrolled section 902 corporation*									

Part III Overall Foreign Loss Account Balances (Section 904(f)(1))

1 Beginning balance									
2 Current year additions									
3 Current year reductions (other than recapture)	()	()	()	()	()	()	()	()	()
4 Subtotal —Combine lines 1 through 3									
5 Current year recapture									
6 Ending balance —Subtract line 5 from line 4.									

* Important: If the corporation received dividends from more than one noncontrolled section 902 corporation, see General Instructions.

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Schedule

Part I is used to show adjustments to separate limitation income or (losses) in determining the numerator of the limitation fraction for each separate limitation. Part II is used to show the year-end balances of future separate limitation income that must be recharacterized as income of other separate limitation categories (as the result of current year or prior year separate limitation losses that were allocated to those other separate limitation categories). Part III is used to show the balances in the corporation's overall foreign loss accounts at the beginning of the tax year, any adjustments, and the balances in the overall foreign loss accounts at the end of the tax year.

Note: Schedule J is completed only once, not again for each applicable separate limitation.

Computer Generated Schedule J

A computer generated Schedule J can be filed if it conforms to the IRS version of the schedule. For example, if the corporation received dividends from more than one noncontrolled section 902 corporation, expand Schedule J to properly allocate the separate limitation losses among categories with positive taxable income. Dividends received from each noncontrolled section 902 corporation is a separate limitation.

Specific Instructions

Part I

Note: See Notice 89-3, 1989-1 C.B. 623, and Regulations section 1.904(f)-12 for more information on the ordering of adjustments to each separate limitation income or (loss) category in arriving at the numerator of the limitation fraction for each separate limitation.

Line 1.—Enter in each applicable column the separate limitation income or (loss) from column 12 of the corresponding Schedule A for that separate limitation.

Important. Be sure to consider on this line the possible interplay between the separate limitation losses and any net operating losses or net capital losses of which they may be a part.

Line 2.—This allocation grid must be completed to show the pro rata share of each separate limitation loss to allocate among other applicable separate limitations. To determine each pro rata share:

a. Add all of the separate limitation loss amounts entered across line 1. Then, add all of the separate limitation income amounts entered across line 1.

b. If the combined separate limitation losses for the tax year **do not exceed** the combined separate limitation income for the tax year, the pro rata share of each separate limitation loss to allocate to each category with positive taxable income is as follows:

$$\frac{\text{Separate limitation income}}{\text{Combined separate limitation income from all categories with positive taxable income}} \times \text{Separate limitation loss being allocated}$$

c. If the combined separate limitation losses for the tax year **exceed** the combined separate limitation income for the tax year, the pro rata share of each separate limitation loss to allocate to each separate limitation having income is as follows:

$$\frac{\text{Separate limitation loss being allocated}}{\text{Combined separate limitation losses from all categories with taxable losses}} \times \text{Separate limitation income in a given category}$$

If separate limitation losses can be allocated, enter the total amounts allocated in the bold-outlined boxes as positive numbers. Enter each separate amount allocated to a given separate limitation across the same line under the appropriate column heading to which it was allocated.

Note: The numbers entered across any given line should "zero out."

The combined separate limitation losses for the tax year that are more than the combined separate limitation income for the tax year reduce the U.S. source income (if any) for the tax year. If the corporation has no U.S. source income for the tax year, **or** if the excess of its combined separate limitation losses for the tax year over combined separate limitation income for the tax year exceeds its U.S. source income for the tax year, the excess is treated as a net operating loss. This loss may be carried over or back to other tax years according to the rules of section 172.

Example 1. Corporation X has separate limitation income of \$4,000 in its general limitation income category (line 1, column (i)) and separate limitation income of \$1,000 in its financial services income category (line 1, column (iv)). In addition, the corporation has a separate limitation loss of \$2,000 in its shipping income category (line 1, column (v)).

Because the corporation's combined separate limitation losses for the tax year (\$2,000) **do not exceed** its combined separate limitation income for the tax year (\$5,000), the entire \$2,000 may be allocated to other separate limitations. Therefore, Corporation X enters a positive \$2,000 in the bold-outlined box on line 2e, column (v).

To compute the portion of the \$2,000 separate limitation loss that is allocable to general limitation income, Corporation X divides the \$4,000 of separate limitation income by \$5,000 (the combined separate limitation income from all categories with positive taxable income). The result of 80% is multiplied by the separate limitation loss of \$2,000. Corporation X enters the product of \$1,600 on line 2e, column (i).

To compute the portion of the \$2,000 separate limitation loss that is allocable to financial services income, Corporation X divides the \$1,000 of separate limitation income by \$5,000. The result of 20% is multiplied by the separate limitation loss of \$2,000. Corporation X enters the product of \$400 on line 2e, column (iv).

Corporation X enters \$2,400 (\$4,000 minus \$1,600) on line 3, column (i); \$600 (\$1,000 minus \$400) on line 3, column (iv); and \$0 (negative \$2,000 plus positive \$2,000) on line 3, column (v).

Line 4.—Enter the overall foreign losses for the tax year (from line 3) if they have reduced U.S. source income for the tax year.

If an overall foreign loss has reduced U.S. source income, do not complete the remainder of Part I for that separate limitation. However, complete Parts II and III for that separate limitation to show the year-end balance in the separate limitation loss and overall foreign loss accounts.

Line 5.—Recapture overall foreign losses that reduced U.S. source income in prior tax years (section 904(f)(1)). Do this by treating a portion of the current year separate limitation income that is of the same limitation category as the loss that resulted in the prior year overall foreign loss as U.S. source income. Recapture continues until the applicable overall foreign loss account balance (Part III of this schedule) is reduced to zero.

The amount of any current year separate limitation income subject to recapture is the smaller of the balance in the applicable overall foreign loss account (the applicable line 1 amount of Part III of this schedule) **or** 50% of all amounts entered on line 3, Part I of this schedule. The corporation can make an annual, revocable election to recapture a greater portion of the balance in an overall foreign loss account. Make the election by attaching a statement to Form 1118 indicating the percentage and dollar amount of the separate limitation income that is treated as U.S. source income and the percentage and dollar amount of the balance (both before and after recapture) in the overall foreign loss account that is recaptured.

Line 7.—If a separate limitation loss was allocated in a prior tax year, and the corporation has income during the current tax year in the separate limitation category from which the loss was allocated, that current year income (if it was not previously recharacterized) must be recharacterized as income of the separate limitation(s) to which the loss was allocated in the prior year(s) (section 904(f)(5)).

If a prior year separate limitation loss was allocated to more than one separate limitation category **and** there is not enough current year income in the separate limitation category from which the loss was allocated to recharacterize all remaining balances, then the current year income must be recharacterized as income of the other separate limitations on a pro rata basis in the following manner:

Current year income in separate limitation category from which losses were previously allocated	×	Amount remaining to be recharacterized as income of a given separate limitation	
		Amounts remaining to be recharacterized as income of all separate limitations	

Any amount that is not recharacterized during the tax year (i.e., the excess of separate limitation losses previously allocated over current year income in that same separate limitation category) must be entered into the grid at Part II of this schedule.

Note: *Recharacterization of separate limitation income does not result in recharacterizing any tax. The rules of Regulations section 1.904-6 apply on an annual basis for allocating taxes to separate limitations.*

If prior year separate limitation losses can be recharacterized, the total amounts recharacterized should be entered into the bold-outlined boxes as negative numbers. Each prior-year separate limitation loss recharacterized should be entered as a positive number on the same line under the appropriate column heading to which it was recharacterized.

Note: *The numbers entered across any given line should "zero out."*

Example 2. Assume the same facts in Example 1 on page 3. Also assume that, in a subsequent tax year, Corporation X has \$1,500 of income in its shipping income separate limitation category (on line 6, column (v), of its Schedule J).

Because there is not enough under shipping income to recharacterize the

entire \$2,000 prior-year balance remaining to be recharacterized, Corporation X will prorate the \$1,500 of income in that subsequent year as follows:

To compute the portion to be recharacterized as general limitation income, Corporation X divides the \$1,600 remaining to be recharacterized from shipping income to general limitation income by the \$2,000 remaining to be recharacterized from shipping income to all separate limitations. The result of 80% is multiplied by the \$1,500 of shipping income. Corporation X enters \$1,200 as a positive number on line 7e, column (i).

To compute the portion to be recharacterized as financial services income, Corporation X divides the \$400 remaining to be recharacterized from shipping income to financial services income by \$2,000. The result of 20% is multiplied by the \$1,500 of shipping income. Corporation X enters \$300 as a positive number on line 7e, column (iv).

Corporation X enters the \$1,500 of shipping income that was recharacterized in the bold-outlined box at line 7e, column (v). Note that the total amounts entered across line 7e now equal zero.

Finally, Corporation X completes the Part II recharacterization balances grid by entering \$400 (\$1,600 minus \$1,200) on line e, column (i), and \$100 (\$400 minus \$300) on line e, column (iv).

Line 10.—Enter the U.S. source losses allocated to separate limitation income during the tax year. Use the following formula:

U.S. source loss	×	Income in the separate limitation category	
		Combined separate limitation income	

U.S. source losses that are part of a net operating or net capital loss that are carried back or forward to another tax year (section 172 or Regulations sections 1.1502-21(b) and 1.1502-79(a)) are allocated first to U.S. source income for the tax year to which the losses are carried, and then to the separate limitation income for the current tax year according to the rules set forth above.

U.S. source losses in excess of the separate limitation losses for a tax year must be treated as net operating losses that may be carried back or forward to other tax years using the rules of section 172.

Part II

If a separate limitation loss was allocated in a prior tax year and the corporation has income during the current tax year in the separate limitation category from which the loss was allocated, that current year income (if it was not previously recharacterized) must be recharacterized as income of the category to which the loss was allocated in the prior year(s) (section 904(f)(5)).

To determine the amounts to enter into the grid:

1. Add the current year separate limitation loss allocations (subject to Regulations section 1.904(f)-1(d) capital gains adjustments) to last year's year-end balances.

2. Subtract the amounts recharacterized during the current tax year.

Enter the result on the line (line a–i) for the separate limitation category from which losses were previously allocated, under the appropriate column (column i–ix) to which the losses were previously allocated.

Example 3. Assume the same facts in Example 1 on page 3. Also assume that Corporation X does not have any remaining balances from any prior allocations of losses from its shipping income separate limitation to its general limitation income or its financial services income separate limitations. The corporation should enter \$1,600 on line e, column (i), and \$400 on line e, column (iv).

Part III

Show the balances in the corporation's overall foreign loss accounts at the beginning of the tax year, any adjustments, and the balances in the overall foreign loss accounts at the end of the tax year for **each** separate limitation (Regulations section 1.904).

Line 1.—Enter the ending balances from last year's schedule.

Lines 2, 3, and 5.—Use these lines to show any adjustments made to the overall foreign loss accounts for each separate limitation during the tax year. A list of possible additions to the accounts is shown in Regulations section 1.904(f)-1(d) and a list of possible reductions (including recapture) is shown in Regulations section 1.904(f)-1(e).

Line 5.—Enter the applicable amount(s) from Part I, line 5.

Line 6.—Enter the year-end balances of the overall foreign loss accounts for each separate limitation.