Instructions for Schedule I (Form 1120-F) for 2007 Tax Year

Interest Expense Allocation Under Regulations Section 1.882-5

General Instructions

Purpose of Schedule

Schedule I (Form 1120-F) is used by the foreign corporation filing Form 1120-F to report the amount of interest expense allocable to effectively connected income ("ECI") and the deductible amount of such allocation for the taxable year under section 882(c) and regulations section 1.882-5 and Temporary regulations section 1.882-5T. The schedule also identifies the various elections the taxpayer uses and discloses the basic calculations for the year under the rules of Temporary regulations section 1.882-5T(a)(7), 1.882-5T(d)(5) and under the branch profits tax regulations under Temporary regulations section 1.884-1T(e)(3). **Note**: The section 1.882-5T and 1.884-1T(e)(3) tax elections are not effected under the regulations by their identification on Schedule I (Form 1120-F). See the requirements for the time, place and manner for making the interest expense allocation and branch profits tax liability reduction elections under section 1.882-5T(a)(7) and 1.884-1T(e)(3).

Under Reg. Section 1.882-5 and 1 .882-5T, the amount of interest expense of a foreign corporation that is allocable under section 882(c) to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States is the sum of the interest allocable by the foreign corporation under the three-step process set forth in paragraphs (b), (c), and (d) or (e) of the regulation and the directly allocated interest expense determined under paragraph (a)(1)(ii) of the regulation. The interest allocation rules of §1.882-5 and §1.882-5T are the exclusive rules for allocating interest expense under §882(c) to effectively connected income and for attributing interest expense to business profits of a U.S. permanent establishment under all income tax treaties other than treaties that expressly permit attribution of business profits to a U.S. permanent establishment under application of the OECD Transfer Pricing Guidelines principles by analogy. See United States-United Kingdom Income Tax Treaty, Article 7 (July 24, 2001); United States-Japan Income Tax Treaty, Article 7 (November 6, 2003) and accompanying Exchange of Notes. If the foreign corporation files its tax return using a treaty-based method of the type provided in these treaties complete and attach Form 8833 to the Form 1120-F tax return to disclose the treaty position taken.

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

Reporting corporation.

A reporting corporation is any foreign corporation that is engaged in a trade or business or treated as engaged in a trade or business within the United States directly or indirectly at any time during the taxable year.

Other Forms and Schedules related to Schedule I.

- ***Form 1120-F Schedule L***. The set or set(s) of books that give rise to U.S. booked liabilities under section 1.882-5(d)(2) and 1.882-5T(d)(2) are the same sets of books and records that are reportable as of the taxable year end on Form 1120-F, Schedule L and by foreign banks to report income and expenses on Schedule M-3 (Form 1120-F).
- ***Form 1120-F, Section III, Part II – Branch-Level Interest Tax***. The amount of interest expense from line 24d is reportable on Form 1120-F, Section III, Part II, line 7b. The amount of the allocation under section 1.882-5 reportable on line 23 is reportable on Form 1120-F, Section III, Part II, line 7c.
- ***Schedule M-3 (Form 1120-F), Part III, lines 26b and 26c***. The amount of interest expense allocation reportable on Schedule I, line 23 is includable on Schedule M-3 (Form 1120-F) on line 26b, columns (c) and (e). The amounts subject to deferral and disallowance on lines 24a – 24c are reportable on Schedule M-3 (Form 1120-F) line 26(c) in columns (b), (c) and (e).
- ***Schedule P (Form 1120-F)***. Enter amounts from Schedule P (Form 1120-F), lines 19, 17 and 14c on Schedule I, in the respective lines 5 column (b), line 8 column (b) and line 9 column (b).

Assets and Liabilities based on Schedule L Set(s) of Books and Records

Generally, the assets and liabilities required to be reported on Schedule L are the total assets and liabilities reflected on the set or sets of books of the foreign corporation that give rise to income effectively connected with the corporation's trade or business within the United States and U.S. booked liabilities (as defined in §1.882-5(d)(2) and §1.882-5T(d)(2)(ii)(A) and (iii)). The total assets and liabilities reflected on such books include the interbranch assets and liabilities and assets that give rise to noneffectively connected income in whole or in part. Such books will reflect the assets of the foreign corporation located in the United States and all other of its assets used in its trade or business within the United States (other than its assets giving rise to effectively connected income under sections 864(c)(6) or (7)), as authorized under section 1.6012-2(g)(1)(iii). A foreign corporation may instead report its worldwide assets/liabilities on Schedule L.

If the foreign corporation has more than one set of books and records relating to assets located in the United States or assets used in a trade or business conducted in the United States, it must report the combined amounts on Schedule L and must eliminate asset and liability amounts recorded between these books.

Who Must Complete

All foreign corporations that have interest expense allocable to ECI under §882(c) must complete Schedule I to report this allocation, regardless of whether the amount allocable under section 1.882-5 is deductible in the current year, or is otherwise deferred or permanently disallowed under other sections of the Internal Revenue Code (e.g. sections 163(e), 163(j), 263A, 265(a). 267(a)(3)). The information reported on Schedule I is also needed, for completion of Section III of Form 1120-F, (the determination of the branch-level interest tax under section 884(f)). Interest expense that is treated as “branch interest” under §1.884-4(b) may be subject to information reporting under section 1461 or section 6049 and potential withholding under sections 1441 and 1442. A Foreign corporation that is a reporting corporation and required to file Form 1120-F must complete Schedule I and attach it to the Form 1120-F that it is filing.

Treaty-based return positions. If the corporation reports its interest expense attributable to its business profits of a U.S. permanent establishment pursuant to the express provisions and accompanying documents of an applicable treaty instead of under section 1.882-5, then Page 1 of Schedule I, lines 1 – 9 must be completed and attached to Form 1120-F.

Exceptions from filing Schedule I.

A foreign corporation is not required to file Schedule I if it either (a) does not have a trade or business within the United States; (b) the foreign corporation has no worldwide interest expense for the taxable year to allocate under section 1.882-5; or (c) the foreign corporation conducts limited activities in the United States for the taxable year, which the foreign corporation determines does not give rise to effectively connected income or the corporation does not have a U.S. permanent establishment to which business profits are attributable, and the corporation files a protective income tax return under section 1.882-4(a)(3)(vi).

Protective Elections on protective returns. However, a corporation that files a protective tax return on Form 1120F under section 1.882-4(a)(3)(vi), may voluntarily file Schedule I with the protective return to preserve timely elections under §1.882-5T(a)(7) if the return is filed by the original due date (including extensions) that otherwise applies to Form 1120-F. The protective elections are not effective if filed during the additional extended period described under regulations section 1.882-4(a)(3). The foreign corporation need only complete the relevant portions of Schedule I with respect to its right to adopt the following elections:

- **the adjusted basis or fair market value** method for valuing its average assets in steps 1 and 2 of the computation (Line 1);
- **the fixed or actual** ratio in step 2 (Line 6);
- **the Adjusted U.S. Booked Liability method (“AUSBL”) or Separate Currency Pools (“SCP”) method in Step 3** (Item B);

- **the published LIBOR election for banks under the AUSBL method in Step 3** (Line 10-check box and Line 10d); and
- **the de minimis foreign currency election under the Separate Currency Pools method in Step 3** - check box on line 16).

The corporation need only identify the election in the first year it is required to be made under section 1.882-5T(a)(7) or in any year a taxpayer is eligible to adopt or change an election and chooses to do so for that year. For example, an election to use the adjusted U.S. booked liability method or the separate currency pools method is an election that generally must be maintained for a minimum five-year period. If a corporation is subject to section 1.882-5 for the first time, the election is due with a timely filed return (excluding the additional extended period provided by regulations section 1.882-4(a)(3)) whether or not the taxpayer files a protective return under section 1.882-4(a)(3)(vi). The election need not be shown on Schedule I for any subsequent year to which the minimum five-year period applies. However, the indication of the election with a protective return is only effective for a year that the corporation is engaged in trade or business within the United States. Accordingly, if a protective election is made for a first year protective return and in fact the taxpayer is not engaged in trade or business until the second year of activity within the United States, the protective election made in the first year is not effective for the corporation's second year of activity because section 1.882-5 is not applicable to the corporation until such second year.

A corporation that files a protective return under section 1.882-4(a)(3)(vi), need not report numbers on Schedule I (other than the published LIBOR election on line 10d) in order to preserve an allocation method. If a taxpayer files a protective return under section 1.882-4(a)(3)(vi) and does not file Schedule I to identify the relevant elections under section 1.882-5 for an applicable year, then the Director of Field Operations is authorized to make all applicable allocation method elections on behalf of the corporation for such applicable year if it is later determined that the taxpayer was engaged in trade or business within the United States and had ECI during the year.

Note: Under Section 1.882-5T(a)(7), no interest expense allocation elections may be made on an amended return. In addition, the rules for requesting relief for late tax elections in section 301.9100-1 and any guidances promulgated thereunder are not available. An election to change from a fair market value method to a previously elected adjusted basis method for reporting U.S. assets on line 6 may not be made without advance consent of the Commissioner or his delegate. See section 1.882-5T(b)(2)(ii)(A).

Required Reporting on Schedule I

Page 1: Lines 1 – 9. Schedule I requires disclosure of data and interest allocation elections for all parts of the three-step formula under section 1.882-5 and 1.882-5T. Page 1 provides data input for Step 1 (Lines 1-5: determination of average

U.S. assets) and Step 2 (Lines 6-7c, determination of U.S.-connected liabilities) and for the determination of U.S. booked liabilities and U.S. booked interest expense under section 1.882-5(d)(2) and 1.882-5T(d)(2) (Lines 8 – 9). The information on line 9 column (c) is also used for purposes of determining the corporation's branch interest under section 884(f)(1)(A) and §1.884-4(b) and in the calculation of the corporation's branch-level interest tax on excess interest under section 884(f)(1)(B) and section 1.884-4(a). Line 8 column (c) and line 9 column (c) are also included in the interest expense allocation computation in Step 3 of the AUSBL method if elected by the corporation.

Lines 1 through 9 must be completed by all corporations required to file Schedule I regardless of whether the corporation allocates interest expense under the AUSBL or Separate Currency Pools method for the applicable year. Schedule I, lines 1-9 must also be completed and attached to Form 1120-F for all years the corporation files its income tax return to report business profits attributable to a U.S. permanent establishment (other than under the ECI rules of sections 864(c), 882(a) and 882(c)) pursuant to the express provisions of applicable income tax treaty and accompanying documents (such as Exchange of Notes).

Page 2 - Step 3 Allocations, Direct Interest Allocations, deferrals and other disallowances. ***Step 3 methods: lines 10 - 20***. Step 3 of the AUSBL method is provided in lines 11 through 15. The Step 3 Separate Currency Pools method is reported on lines 16-21. These Step 3 methods are mutually exclusive and cannot both apply to the corporation in the same year. The methods are subject to the general five-year minimum period election rules of section 1.882-5T(a)(7).

AUSBL method filers. AUSBL method filers complete lines 1 through 15 and lines 21 through 25. Do not complete lines 16-20.

Separate Currency Pools method filers. Separate Currency Pools method filers complete all columns on lines 1 through 9 and lines 16 through 25. Do not complete lines 11 through 15.

Direct interest allocations-Line 22. Interest expense that is directly allocable under section 1.882-5(a)(1)(ii) in accordance with the rules of Temporary regulations section 1.861-10T(b) or (c), is reported on line 22.

Summary of section 1.882-5 allocation – Line 23. The amount of interest expense allocable to effectively connected income under section 1.882-5 is the sum of the amount allocated under either the AUSBL or Separate Currency Pools method on line 15 or 20, and the amount directly allocated to ECI and reportable on line 22. The resulting amount allocable and reported on line 23, is also reconciled and reported on Form 1120-F, Section III, Part II, Branch-Level Interest Tax, line 7c.

Deferrals and Disallowances under other Code Sections – Line 24. The interest expense allocation reportable on line 23 is determined under section 1.882-5 before application of other Code sections that defer or disallow the interest deduction in whole or in part. See section 1.882-5(a)(5).

Specific Instructions by Line Item:

Foreign Banks – Item A: Check Box for a Bank (as defined in section 1.882-5T(c)(4))

At the top left of Schedule I, check the box with an “x” if the foreign corporation is a bank as defined in section 1.882-5T(c)(4). The term “bank” is defined in the regulation as a bank that meets the statutory definition applicable to domestic banks (except for the fact the corporation is foreign) and without regard to whether the corporation’s required banking activities are effectively connected with its trade or business within the United States. The required banking activities need only be conducted on a worldwide basis. To qualify as a bank for interest expense allocation purposes, the foreign corporation must be subject to bank regulatory supervision and examination in its home country of a type similar to that required of domestic banks by State or Federal authority having supervision over banking institutions, and a substantial amount of the corporation’s business must consist of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency. See Sections 581 and 585(a). **Note**: The reference to the definition of the term “bank” for purposes of determining the U.S. booked liabilities of banks under section 1.882-5(d)(2)(iii) and Temporary regulations section 1.882-5T(d)(iii)(A) does require that the corporation meet the section 585(a)(2) regulated banking requirements in its trade or business within the United States. The section 585(a)(2) standard determination at the U.S. trade or business level also applies for purposes of electing the deposit liability safe harbor applicable to the reduction of excess interest under regulations section 1.884-4(a)(2)(iii).

Page 1 – Lines 1 through 9: All Foreign Corporations- Column and Line Specific Instructions

Lines 1 through 5: Step 1 Determination of U.S. Assets

Assets includable in lines 1 through 5 are the U.S. assets of the corporation as defined in regulations sections 1.882-5(b), 1.882-5T(b) and 1.884-1(d). The U.S. assets are valued on an average basis for interest expense allocation purposes.

Frequency of averaging:

The average value of assets for this step is to be computed at the most frequent, regular intervals for which data is reasonably available. See Section 1.882-

5T(b)(3). *Foreign banks*. The minimum averaging period for a foreign bank is monthly (beginning of taxable year and monthly thereafter). *For corporations other than a bank*, the minimum averaging period is semi-annually (beginning, middle and end of the taxable year).

Line 1, check box. Indicate whether the corporation values its U.S. assets on the adjusted basis method (see section 1.882-5(b)(2)(i)) or whether it has elected the fair market value method (see section 1.882-5T(b)(2)(ii). The adjusted basis method election is subject to the minimum five-year period described in section 1.882-5T(a)(7). The fair market value method cannot be changed to the adjusted basis method without advance consent from the Commissioner or his delegate.

Note: For lines 2, 3 and 4, enter amounts only in column (a).

Line 2, column (a). Total assets per books. Enter the total average assets derived from the combined set or set(s) of books that are reportable on Schedule L. The total average assets should include interbranch balances with other set(s) of books of the corporation that are not reportable on Schedule L.

Line 3a, column (a). Total Interbranch Assets
Enter on line 3 column (a), the total of the corporation's average interbranch assets included in line 2 above. The average interbranch assets recorded on the set(s) of Schedule L books do not create U.S. assets under section 1.882-5(b)(1)(iv) and are disregarded for purposes of the interest expense allocation rules. **Note**: If under the global dealing proposed regulations (Prop. Regulations sections 1.863-3(h) which reference proposed regulations section 1.482-8 principles), the corporation recognizes an amount recorded as an interbranch asset, such amount is treated as the allocation and source of third-party securities dealing income and is not eliminated from U.S. assets in line 3, column (a).

Line 3b column (a). Total non-ECI assets under section 864(c)(4)(D)
Enter line 3b column (a), the average assets included in Line 2 that give rise to non-ECI received from foreign-related corporations under section 864(c)(4)(D). Such amounts include assets from transactions with foreign-related corporations that give rise to foreign source dividends, interest, rents or royalties whether or not such amounts are attributable to a U.S. office of the corporation under section 864(c)(4). A foreign related corporation is a foreign corporation the taxpayer owns (under section 958(a)) or is treated as owning (under section 958(b)) more than 50 percent of the total combined voting power of all classes of stock entitled to vote. Enter the average asset number for assets described in section 864(c)(4)(D) on line 3b, column (a), regardless of whether such assets give rise to non-ECI under another Code section or regulation. For example, report income that is non-ECI under section 864(c)(4)(D) on line 3b, column (a) even if such income is also not attributable to a U.S. office of a banking, financing or similar business under regulations section 1.864-6(b)(2)(ii)(*b*) and the principles of regulations section 1.864-4(c)(5)(ii).

Line 3c, column (a). Total other Non-ECI Assets
Enter on line 3c, column (a), all other assets (or portion thereof) included in line 2, that give rise to domestic or foreign source non-ECI. If income from a security is treated as partially ECI and partially non-ECI under section 1.864-4(c)(5)(ii), enter the amount of the asset on line 3, column (c) in the proportion that the income, gains and loss from such asset that are treated as non-ECI bear to the total income, gains and loss from the asset. Do the same for the non-ECI portion of any asset whose income is allocated under the proposed global dealing regulations or under an Advance Pricing Agreement pursuant to a competent authority agreement. See Prop. Regulations sections 1.884-1(d)(2)(vii) and 1.884-1(d)(2)(xi) Example 8.

Line 3d, column (a). Adjustment for amounts from partnerships and certain disregarded entities included on line 2, column (a). Enter the average amount included in line 2, column (a) for the entire amount recorded for investments in partnerships and disregarded entities. The ECI portion of the corporation's adjusted outside basis in a partnership is reportable on line 5, column (b). Investments in disregarded entities should not be included in line 2, if the set(s) of books are reportable on Schedule L. The assets and liabilities of such books should be combined in line 2 with all other set(s) of books reportable on Schedule L.

Line 3e, column (a). Adjustments for assets that give rise to direct interest expense allocations under Section 1.882-5(a)(1)(ii). Enter on line 3e, column (a), the average value of the portion of all assets included in line 2 that give rise to direct interest expense allocations under section 1.882-5(a)(1)(ii) in accordance with the requirements of section 1.861-10T(b) or (c), and 1.861-10T(d). A foreign corporation that allocates its interest expense under the direct allocation rule of this regulation section shall reduce the basis of the asset that meets the requirements of §1.861-10T (b) or (c) by the principal amount of the indebtedness that meets the requirements of §1.861- 10T (b) or (c). The amount of directly allocable interest under section 1.882-5(a)(1)(ii) is reported on line 22.

Line 3f, column (a). Other adjustments to average assets included in line 2.
Enter on line 3f, column (a), the average asset balances for any other amounts included in line 2 that do not constitute U.S. assets as defined in section 1.884-1(d). Assets includable on this line may include, for example, amounts with respect to securities that are marked to market for tax purposes under section 475 that are not marked to market on the set(s) of books reported in line 2. If the mark-to-market amount includable for tax purposes is an increase to the basis of the assets included in line 2, include such increase as a negative number in column (a). Similarly, if the mark to market amount decreases the basis of the assets included in line 2, include such decrease as a positive number in column (a). Other adjustments for book tax differences with respect to asset values in line 2, such as depreciation and amortization for taxpayers using the adjusted basis

method for valuing U.S. assets, are also reportable on line 3f, column (a). Enter the aggregate net increase as a negative number or aggregate net decrease as a positive number.

Line 4. Combine lines 3a through 3f and enter the amount,on line 4. The amount on lne 4 constitutes the total net adjustment to the average book assets from the Schedule L set(s) of books reported in line 2.

Line 5. Total Value of U.S. assets for the Tax Year.

Line 5, column (a). Average U.S. Assets on set(s) of Schedule L books (Line 2 column (a) minus line 4 column (a)). Subtract the amount on line 4, column (a) from line 2, column (a) and enter the amount on line 5, column (a). The resulting amount is the total average value of U.S. assets under section 1.884-1(d) included on the Schedule L set(s) of books, excluding any partnership interests included in line 2.

Line 5, column (b). ECI portion of the Average value of partnership interests. Enter on line 5, column (b), the amount from Schedule P (Form 1120-F), line 19, Total column. This amount is the sum of all ECI portions of the corporation's outside basis in partnership interests as adjusted under section 1.884-1(d)(3). The amount entered from Schedule P, line 19 may include the ECI portion of the corporation's outside basis in partnerships whose book value is included in line 2 as well as the ECI portion of partnership interests whose book value is not recorded on the Schedule L books and is not included in line 2.

Line 5, column (c). Average U.S. Assets not includable in set(s) of books reported on Schedule L, line 5 column (a), or from partnerships reported on line 5, column (b). Enter on line 5 column (c), the average value of U.S. assets (other than the ECI portion of the corporation's outside basis in partnership interests) from set(s) of books that are not reportable on Schedule L. Such assets may generally include certain securities attributable to a U.S. office of a banking, financing or similar business that are booked in a foreign bank's home office or other foreign location. Other assets reportable on line 5, column (c), may generally also include assets that are no longer held in connection with a trade or business within the United States that give rise to effectively connected income under section 864(c)(6) or section 864(c)(7). However, not all assets that give rise to ECI including ECI recognized under section 864(c)(7), constitute U.S. assets under section 1.884-1(d). See section 1.884-1(d)(2)(xi) example 5, and section 1.884-1(d)(5).

Line 5, column (d). Total Average Value of U.S. Assets included in Step 1. Combine the amounts on line 5 columns (a), (b) and (c) and enter the amount on line 5, column (d). This amount is the total average value of the corporation's U.S. assets included in Step 1 of the section 1.882-5 formula. If the corporation uses the Separate Currency Pools method to allocate interest expense in Step 3 of the section 1.882-5 formula, see the instructions to line 16a, below. The amount on line 5, column (d) is also reportable on Schedule H (Form 1120-F), line 23a.

Step 2: Determination of U.S.-Connected Liabilities - Regulations Section 1.882-5(c) (lines 6 – 7c)

Specify Actual Ratio or Fixed Ratio method. Check the applicable “actual ratio” or “fixed ratio” box to specify whether the corporation uses the actual or the fixed ratio method for the taxable year to determine its U.S.-connected liabilities in Step 2 of the allocation formula**.** The amount of U.S.-connected liabilities is the total value of U.S. assets for the taxable year, line 5, column (d), multiplied by the actual ratio or the applicable fixed ratio the corporation has timely elected for the taxable year. The actual ratio or fixed ratio election must be made on a timely tax return for the first year the corporation is subject to section 1.882-5 and is subject to the minimum five-year period under section 1.882-5T(a)(7). An election to change the method after such minimum five-year period is also subject to the minimum five-year period.

Foreign banks (described in section 1.882-5T(c)(4). The fixed ratio is 95%.
Corporations other than banks. The fixed ratio is 50%.

Actual ratio information. If the corporation uses the actual ratio, complete lines 6a through 6c and skip line 6d**.**
Fixed ratio information. If the corporation uses the fixed ratio, skip lines 6a through 6c and enter the applicable fixed ratio on line 6d**.**

Actual Ratio filers- Regulation Section 1.882-5(c)

Line 6a - Average Worldwide Liabilities. Enter the average worldwide liabilities as adjusted for U.S. tax principles for the year on line 6a. The corporation’s worldwide liabilities include the liabilities of only the corporation filing the Form 1120F plus any liabilities of any disregarded entities that are treated as liabilities of the foreign corporation under U.S. tax principles. The books of the foreign corporation and any such disregarded entities must be combined, with applicable eliminating entries for transactions between them. See regulations section 1.882-5(c)(2)(viii). The classification of the worldwide liabilities is determined under U.S. tax principles. See section 1.882-5(c)(2). The value of the worldwide liabilities is determined under substantial U.S. tax principles. Foreign banks must average the worldwide liabilities using the beginning, middle and end of year values. Corporations other than banks must average the worldwide liabilities using the year-to-year values of its liabilities.

Line 6b – **Average Worldwide Assets**. Enter the average worldwide assets as adjusted for U.S. tax principles on line 6b, using the same nonconsolidated books for reporting average worldwide liabilities in Line 6a. Transactions with disregarded entities included in the actual ratio computation constitute interbranch transactions under U.S. tax principles and also eliminated. See regulations section 1.882-5(c)(2)(viii). Use the same averaging period applicable to worldwide liabilities. If the corporation uses the actual ratio method, the amount entered on line 6b is also reported on Schedule H (Form 1120-F), line 23b.

Line 6c – Actual ratio percentage. Divide the amount on line 6a by the amount on line 6b and enter the percentage on line 6c.

Fixed Ratio filers - Regulation section 1.882-5T(c)(4)

Line 6d. Fixed Ratio. Enter the applicable 95-percent ratio (foreign bank) or 50-percent ratio (corporations other than banks) on line 6d**.**

Line 6e. Step 2 Ratio used. Enter the applicable actual ratio percentage from line 6c or the fixed ratio percentage from line 6d.

Line 7 U.S.-connected Liabilities and Liability Reduction Election Amount

Line 7a. U.S.-connected liabilities before section 1.884-1(e)(3) election(s). Multiply the average U.S. assets from line 5, column (d), by the ratio entered on line 6(e) and enter the result. The result is the amount of U.S.-connected liabilities determined before the application of any liability reduction election(s) made under regulations section 1.884-1(e)(3) and Temporary regulations section 1.884-1T(e)(3).

Line 7b. U.S. liability reduction election amount. Enter the total amount of all liability reduction election amounts made under section 1.884-1(e)(3) and 1.884-1T(e)(3). **Note:** A liability reduction election may be made only to the extent needed to reduce a dividend equivalent amount under section 884 to zero See 1.884-1T(e)(3) for the time, place and manner for making the liability reduction election and the separate disclosures required to be attached to Form 1120-F for each liability reduction election made. If the corporation uses the Separate Currency Pools Method for Step 3 (Lines 16-20), the amount included on line 7b must also be allocated to determine the U.S.-connected liabilities for each currency. See the instructions to lines 7c and 17b, below. If no liability reduction election is made for the taxable year, enter zero on line 7b.

Line 7c. U.S.-Connected Liabilities. Subtract line 7b from line 7a and enter the amount on line 7c. The amount entered is the amount of U.S.-connected liabilities for determining the amount of interest expense allocable to effectively connected income in Step 3. If the corporation uses the Separate Currency Pools Method for Step 3, the sum of all U.S.-connected liabilities shown on line 17b (including any attachments for lines 16-19 for additional separate currency computations) must equal the amount shown on Line 7c after the liability reduction election has been taken into account.

Step 3: Interest expense allocation (Including U.S. booked liabilities and U.S. booked interest expense included in the determination of branch interest):

All Schedule I filers complete lines 8 and 9.

Line 8. Average Third Party U.S.-Booked Liabilities

Line 8 column (a) – Schedule L U.S. booked liabilities. Enter on line 8 column (a), the average amount of third-party U.S.-booked liabilities from the set(s) of books reportable on Schedule L using the most frequent averaging period available but not less frequently than the minimum averaging periods required for U.S. assets reported on line 5. The average U.S.-booked liabilities include all third-party liabilities on the set(s) of Schedule L books whether interest bearing or not. Exclude interbranch liabilities shown on the Schedule L books unless such amounts are treated as allocations of third-party amounts with respect to a global dealing operation under Prop. Regulations section 1.863-3(h) (e.g. mark-to-market valuations of dealer derivative securities may constitute liabilities that are treated as U.S. booked liabilities includable in line 8, column (a))***.*** Do not include liability amounts on line 8(a) to the extent they give rise to directly allocable interest under section 1.882-5(a)(1)(ii) or are partnership liabilities includable in column (b).

- **Corporations other than banks**. The definition of U.S. booked liability for a corporation other than a bank is described in Section 1.882-5(d)(2)(ii) and 1.882-5T(d)(2)(ii)(A)(2) and (3). Liabilities reflected on the Schedule L books must be recorded on such books reasonably contemporaneous to the time the liability is incurred.
- **Foreign banks**. The liability recorded on the set(s) of Schedule L books, must be a foreign bank that conducts regulated banking operations in the United States as described in section 585(a)(2)(B). **Note**: This requirement applies only for the determination of U.S. booked liabilities and corresponding U.S. booked interest expense. It does not apply for other purposes such as determining the eligibility for the fixed ratio under Step 2, reportable on line 6d. The liability must be recorded on the Schedule L books before the close of the day on which the liability is incurred unless an inadvertent error is shown under the facts and circumstances. See the definition and requirements for U.S. booked liabilities of foreign banks under section 1.882-5(d)(2)(iii)(B) and 1.882-5T(d)(2)(iii)(A). **Note**: The section 585(a)(2)(B) standard also applies for eligibility to reduce excess U.S.-connected liabilities using the deposit liability safe harbor in determining the branch-level interest tax on excess interest under section 1.884-4(a)(2)(iii).

Line 8 column (b). U.S. booked liabilities of partnership interests. Enter on line 8b, the amount from Schedule P, line 17 total column. This amount is the corporation's average U.S. booked liabilities with respect to its distributive share of liabilities during the averaging period from partnerships engaged in trade or business within the United States. The amount reportable on line 8b and Schedule P is the corporation's share of partnership liabilities for which it is allocated a distributive share of interest expense. See Regulations section 1.884-1(d)(3)(vi).

Line 8c. Total U.S. booked liabilities. Enter on line 8c, the sum the amounts entered on lines 8a and 8b.

Line 9. U.S. booked interest expense.

Line 9 column (a). Schedule L booked interest expense. Enter the amount of third-party interest expense from the Schedule L set(s) of books with respect to liabilities reported on line 8 column (a). Do not include interest expense that is directly allocable under regulations section 1.882-5(a)(1)(ii), including the corporation's distributive share of direct interest expense allocations from partnerships reportable in column (b).

Line 9 column (b). U.S. booked interest expense from partnerships. Enter on line 9, column (b), the amount from Schedule P (Form 1120-F), line 14c Total column.

Line 9 column (c). Total U.S. booked interest expense. Add the amounts in line 9 column (a) and line 9 (b) and enter the total on line 9 column (c). The entered amount is also required to be reported on Form 1120-F, Page 5, Section III, line 8. This amount is the corporation's tentative branch interest for purposes of the branch-level interest tax under regulations section 1.884-4(b). See the instructions for Form 1120-F, SectionIII, Part B, line 8.

Page 2 – Step 3: Adjusted U.S. Booked Liabilities Method: Lines 10 – 15

If line 7 exceeds line 8, the corporation has "excess interest" as defined in section 884(f)(1)(B) and must complete lines 10 through 13 and skip lines 14a and 14b. If the amount on line 7 is less than or equal to the amount on line 8, skip lines 10 through 13, and complete the determination of the scaling ratio on lines 14a and 14b.

Computation of AUSBL Method Allocation with Excess Interest: Lines 10 through 13.

Line 10. 30-Day LIBOR election for banks – Check Box. If the corporation is a foreign bank that elects to compute excess interest under the AUSBL method using the 30-Day Published U.S. dollar LIBOR rate for the taxable year, check the box on line 10 and skip lines 10a through 10c. Enter the published 30-Day U.S. dollar LIBOR rate used on line 10d. See Regulation Section 1.882-5T(d)(5)(i)(B) for the requirements and separate statement required to be attached to a timely filed Form 1120-F. The 30-Day LIBOR election does not apply to corporations other than foreign banks. For this purpose, the corporation is eligible to make the 30-Day U.S. dollar LIBOR election under the same standard that qualifies the corporation as a bank eligible to make the 95-percent fixed ratio election in Temporary regulations section 1.882-5T(c)(4).

Excess interest – Average actual U.S. dollar rate – Lines 10a through 10c

Line 10a. Actual U.S. dollar interest. If the corporation does not properly make or is not eligible to make a 30-Day LIBOR election for the taxable year, enter the interest expense paid or accrued by the corporation for the taxable year on to its average worldwide U.S. dollar liabilities, excluding U.S.-booked liabilities included on Line 8, column (c).

Line 10b. Enter on line 10b, the average worldwide U.S. dollar denominated liabilities (whether or not interest bearing) that are not U.S. booked liabilities included on Line 8, column (c). See Regulation Section 1.882-5T(d)(5)(ii).

Line 10c. Average U.S. rate on excess U.S.-connected liabilities. Divide the amount on line 10a by the amount on line 10b and enter this percentage on line 10c.

Line 10e. Enter on line 10e, the actual U.S. dollar rate on line 10c or the elective 30-Day LIBOR rate from line 10d, as applicable.

Line 11. Excess U.S.-Connected Liabilities. Subtract 8 from line 7c. and enter this amount on line 11.

Line 12. Excess Interest. Multiply the rate on line 10e by the amount of excess U.S.-connected liabilities on line 11 and enter the amount on line 12. This amount is the corporation's excess interest expense portion of its overall section 1.882-5 allocation that is allocable to effectively connected income under the AUSBL method in section 1.882-5(d)(5). The amount on line 12 also constitutes the corporation's excess interest under section 884(f)(1)(B). See regulations section 1.884-4(a)(2).

Line 13. Interest Expense Allocation. Add the amount reported on line 12 and the amount of U.S. book interest expense from line 9 column (c) and enter the amount on line 13. This amount is the corporation's total amount of interest expense allocable under the three-step formula when U.S.-connected liabilities exceed U.S. booked liabilities under the AUSBL method. It does not include any amounts directly allocable to effectively connected income under section 1.882-5(a)(1)(ii).

Computation of AUSBL Method Allocation under the Scale-Down Ratio. – Lines 14 and 15.

If U.S.-connected liabilities are equal to or less than U.S.-booked liabilities the AUSBL method allocation is subject to a “scale-down” of the U.S. booked interest expense reported on line 9 column (c). Complete lines 14 and 15 in lieu of lines 10 through 15.

Line 14a. Scaling Ratio. Divide the amount on line 7c by the total average amount of U.S.-booked liabilities reported on line 8, column (c) and enter the percentage on line 14a.

Line 14b. Scaled-Down U.S. book interest. Enter the amount of U.S. booked interest on line 9, column (c) by the scale-down ratio on line 14a and enter the amount on line 14b. The allocated amount is the total amount of the AUSBL method allocation under section 1.882-5(d). The amount on line 14b does not include any amount directly allocable to ECI under section 1.882-5(a)(1)(ii). **Hedging amounts**. If the corporation has income, expense, gain or loss from a hedging transaction of a U.S. booked liability that gives rise to interest expense subject to the scale-down ratio, such hedging income, expense, gain or loss amount is also subject to reduction under the same scaling ratio reported on line 14a. See Section 1.882-5(d)(4) and Prop. Regulations section 1.882-5(d)(2)(vi). ***Do not report such scale-down reductions of hedging income, expense, gains or losses on line 14b***. The ratio reported on line 14a shall be applied to each type of item in accordance with its characterization and the scaled down hedging income, expense, gain or loss is reported on Form 1120-F, Section II in the appropriate category to which the hedging item is characterized. For instance, periodic expense from an interest rate notional principal contract hedging transaction that is recorded on the sets of books reportable on Schedule L, and that is subject to the scaling ratio, is reported on Form 1120-F on line 27. Such amount may also be subject to reporting on Schedule H (Form 1120-F), Part IV as allocable to ECI or non-ECi as the case may be.

Line 15 and 21. Interest Expense Allocable to ECI under the AUSBL Method. On line 15, enter the amount from line 13 or 14b, whichever is applicable for the taxable year. Also skip lines 16 through 20 and enter the amount on line 15 on line 21.

Step 3 - Separate Currency Pools Method: Lines 16 through 20.

Corporations that allocate interest expense under a Separate Currency Pools election report the allocations under a three-step method for each currency in which the corporation has U.S. assets (as defined in Section 1.884-1(d)), on Schedule I, lines 16 through 20. The amount of the interest expense allocation is the sum of the separate interest expense allocations in each currency. If the corporation makes a 3% currency election, check the box on line 16b and include all applicable currencies (i.e. currencies that are less than 3% of the corporation's U.S. assets) in the U.S. dollar denominated column on line 16a. The Schedule I form accommodates reporting of the interest expense allocations in four currencies (including the U.S. dollar and the foreign corporation's functional currency). If the foreign corporation has U.S. assets in more than four currencies that are not subject to a 3% currency election, attach a schedule to Schedule I and provide the information for lines 16 through 19 on the attachment for all such additional currencies. Report on Schedule I, line 20, in column (d), the total results for all separate currency allocations shown on line 19 for columns (a) through (d) plus any additional line 19 amounts shown on the attachment (if applicable).

Line 16a. Step 1: U.S. Assets: U.S. Dollar Value Denominated in Currency
Enter the U.S. dollar value of the average amount of U.S. assets in the appropriate column (a) through (d) (or on the attached supplement for additional currencies). Enter in column (a), the U.S. dollar denominated U.S. assets plus the U.S. dollar value of any U.S. assets for which a 3% currency election is applicable for the taxable year. If the 3% election is made, it must be applied to all currency pools in which the average balances of the U.S. assets in such pools for the taxable year are less than 3% of the taxpayer's average U.S. assets for the taxable year. In column (b) enter the average value of U.S. assets denominated in the corporation's home country functional currency. Enter the average U.S. assets of all other currency pools beginning with column (c). **Note**: The sum of all U.S. assets in columns (a) through (d) (and in any supplemental columns shown on a separate attachment, must equal the total average U.S. assets entered on Line 5, column (d)).

A transaction(s) that hedges a U.S. asset is taken into account for purposes of determining the currency denomination and the value of the U.S. asset.
See section 1.882-5(e)(1)(i).

Line 17a. Step 2. U.S.-Connected Liability Ratio
In each column for which a separate currency pool allocation is made, enter the U.S.-connected liability ratio from line 6(e).

Line 17b. Step 2. U.S.-Connected Liabilities per currency
Determination of U.S.-connected liabilities if no U.S. liability reduction election is made. For each applicable column, multiply the U.S. assets on line 16a by the U.S.-connected liability ratio on line 17a and enter the amount on line 17b. The resulting amount constitutes the U.S.-connected liabilities for each currency pool when the corporation does not make a U.S. liability reduction election under sections 1.884-1(e)(3) and 1.884-1T(e)(3).

Determination of U.S.-connected liabilities if a U.S. liability reduction election is made. If the corporation makes one or more U.S. liability reduction elections for the taxable year under sections 1.884-1(e)(3) and 1.884-1T(e)(3), the total amount of the liability reduction shown on line 7b must be allocated to each of the separate currency pools in proportion to the U.S. assets in each pool. To allocate the liability reduction election amount in the determination of U.S.-connected liabilities for each currency pool, the amount entered on line 17b for each column is computed as:

(The amount on line 16a multiplied by the ratio on line 17a)

less

(the amount of the liability reduction election entered on line 7b multiplied by the proportion that the average U.S. assets in the separate currency pool bears to all of the U.S. assets in all separate currencies (i.e. the total average U.S. assets entered on line 5, column (d).

Attach a schedule showing the computation and the allocation of the liability reduction election to each separate currency pool.

Line 18. Determination of the average worldwide borrowing rate for each separate currency pool.

Line 18a. Worldwide book interest expense for each separate currency pool. Enter for each column on line 18a, the corporation's worldwide interest expense paid or accrued for the tax year in the separate currency pool. In column (a), enter the worldwide U.S. dollar interest paid or accrued. For all other separate currency pools, enter the amount in the functional currency of the currency pool. Do not enter the U.S. dollar value of the functional currency pool. See section 1.882-5(e)(2). The worldwide interest expense in each currency pool includes interest expense in each currency that is recorded on the Schedule L books and reportable on Schedule I, line 8(c).

Line 18b. Worldwide average liabilities in each separate currency pool. Enter on line 18b, the average liabilities (whether or not interest bearing) denominated in each separate currency pool. In column (a) enter the average worldwide liabilities (whether or not interest bearing) denominated in U.S. dollars. For all other separate currency pools, enter the average amount of liabilities (whether or not interest bearing) denominated in each currency. Do not enter the U.S. dollar value of the functional currency pool for any column other than column (a). In determining the average worldwide borrowing rate, the liabilities in each currency pool include the amounts recorded on the sets of books reportable on Schedule L and included on Schedule I, Line 9, column (c). Determine the average third-party liabilities using the most frequent averaging period for which data is reasonably available in accordance with the principles of sections 1.882-5T(b)(3) and 1.882-5T(c)(2)(iv).

Line 18c. Average Worldwide Borrowing Rate in each currency pool. For each column, divide the amount on line 18a by the amount on line 18b and enter the percentage on line 18c.

Line 19. Interest Expense Allocation by Separate Currency Pool. For each column, multiply the amount in line 17b by the borrowing rate in line 18c and enter the amount on line 19. The amount on line 19 constitutes the amount of interest expense allocable to ECI in each separate currency pool.

Line 20. Total interest Expense allocable to ECI under the Separate Currency Pools Method. On line 20, enter the sum of the amounts in each column on line 19. The amount on line 20 is the total amount of interest expense allocable to ECI under the Separate Currency Pools method**.**

Summary – Interest Expense Allocation under Regulations Section 1.882-5 and Deductible Amount

Line 21. Interest Expense Allocable to ECI under section 1.882-5(d) or section 1.882-5(e). On line 21, enter the amount of interest expense allocable to ECI from either line 15 or line 20, whichever is applicable for the taxable year.

Line 22. Interest expense directly allocable under §1.882-5(a)(1)(ii)
Enter the amount of interest expense directly allocable to ECI under section 1.882-5(a)(1)(ii). A foreign corporation that has a U.S. asset and indebtedness that meet the requirements of Temporary regulations section 1.861-10T (b) or (c), as limited by 1.861-10T(d)(1), shall directly allocate interest expense from such indebtedness to income from such asset in the manner and to the extent provided in Temporary section 1.861-10T.

Note: See section 1.861-10T(d) for rules requiring reductions in basis to assets required by the direct interest allocation rules in section 1.861-10T(b) or (c). The rules of section 1.861-10T(c) apply only to non-financial institutions. Financial institutions may directly allocate interest expense only under the non-recourse indebtedness rules described in section 1.861-10T(b)

Line 23. **Total Interest Expense allocable to ECI under section 1.882-5**
Add lines 21 and 22 and enter the amount on line 23. This amount is the total amount of interest expense allocable to ECI, including directly allocated interest. This allocable amount may not exceed the total interest expense paid or accrued by the corporation. See section 1.882-5(a)(3). If the corporation's total interest expense paid or accrued is less than the amount of allocation that would result by adding lines 21 and 22, enter such lesser amount on line 23. The amount entered on line 23 is the amount of interest expense taken into account for branch-level interest tax purposes regardless of whether the deductibility of such amount is temporarily deferred, or disallowed for allocation to tax-exempt income (including treaty exempt income). The amount reportable on line 23 is reconciled and

reported on Form 1120-F, Section III, line 7c and on Schedule M-3 (Form 1120-F), Part III, line 26b, columns (d) and (e).

Line 24. Tax-exempt allocations, deferrals and capitalization of interest Expense allocation from line 23. The amount of interest expense allocable to ECI entered on line 23 is subject to additional rules that may defer or disallow deductibility in whole or in part.

Line 24a. *Tax-Exempt allocations*. Report the amount of allocable interest expense on line 23 that is subject to further allocation and apportionment to tax-exempt income under section 265 or under the provisions of an applicable income tax treaty on line 24a. See section 1.882-5(a)(5) examples (3) and (4). Attach a schedule showing how such allocation between exempt and non-exempt ECI has been made. Treaty exempt income may include income that is ECI under the force of attraction principle of section 864(c)(3) but which is business profits not attributable to a U.S. permanent establishment of the corporation under an applicable treaty to which section 1.882-5 applies in determining the attributable business profits. For such treaties, the amount allocable to ECI reported on line 23 requires additional allocation and apportionment between taxable ECI and treaty-exempt ECI under the rule in section 1.882-5(a)(5). **Note**: The amount entered on line 24a, is a bracketed number on Schedule I, and is treated as a reduction of the allocation in determining the deductible interest expense for the year.

***Line 24b. Deferred interest expense*.** Report the amount of allocable interest expense on line 23 that is subject to deferral under sections 163(e)(3), 163(j) or 267(a)(3) in the current taxable year on line 24b. Also report the amount of allocable interest expense deferred under any of these sections in a prior year that is deductible in the current taxable year on line 24b. Attach a schedule indicating the amount of current year deferral and the amount of current year deduction of a prior year deferral for each applicable provision. If the amount of current year deferrals of the interest expense allocated and reported on line 23 exceeds the amount of deductible interest from prior year deferrals, enter the excess current year deferral as a negative number on line 24b. If the deductible amount of prior year deferrals exceeds the current year deferrals, enter the excess deductible amount over the current year deferrals as a positive number on line 24b.

Line 24c. *Capitalized interest expense*. Enter on line 24c, the amount of interest expense allocation reported on line 23 that is capitalizable under section 263A. Attach a schedule describing how such allocation has been made. **Note**: The amount entered on line 24a, is a bracketed number on Schedule I, and is treated as a reduction of the allocation in determining the deductible interest expense for the year.

Line 24d. ***Total deferrals and disallowances*.** Combine lines 24a, 24b and 24c on line 24d. The amount entered on line 24d is also reported and reconciled for its temporary and permanent differences on Schedule M-3 (Form 1120-F) Part III, on line 26 in columns (b) and (c). See specific Schedule M-3 (Form 1120-F) instructions for Part III, line 26.

Line 25. Amount of Allocation deductible on Form 1120F, Part II, Line 18
Combine lines 23 and 24d and enter the result on line 25. The result is the corporation's deductible amount of interest expense allocation for the taxable year and is reportable on Form 1120-F, Part II, line 18. The amount entered on line 25 is also reported on Schedule M-3 (Form 1120-F), Part III, line 26, column (e).