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This confirms our oral advice that the basis limitation rule of §1366(d)(1) applies to limit the amount of creditable foreign income taxes paid or accrued by an S corporation that the S corporation's shareholder may take into account in computing the shareholder's allowable foreign tax credit under §901. Section 1373(a) provides that for purposes of subpart A of part III, relating to the foreign tax credit, an S corporation shall be treated as a partnership, and its shareholders shall be treated as partners of such partnership. Under §703(a), the taxable income of a partnership shall be computed in the same manner as in the case of an individual, except that the items described in §702(a) shall be separately stated, and certain deductions, including the deduction for creditable foreign income taxes described in §§ 901 and 164(a), shall not be allowed to the partnership. Section 703(a)(2)(B). Rather, §702(a)(6) provides that in computing his income tax, each partner shall take into account his distributive share of the partnership's creditable foreign income taxes. Under §§164(a)(3), 275(a)(4), 901(a), and 901(b)(5), each partner may choose to claim either a foreign tax credit or an itemized deduction for creditable foreign income taxes paid or accrued during the taxable year, including his proportionate share of taxes paid or accrued by the partnership. See Treas. Reg. §1.702-1(a)(6).

Similarly, §1366(a)(1) provides, in part, that "in determining the tax under chapter 1 of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends [. . .] , there shall be taken into account the shareholder's pro rata share of the corporation's (A) items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder." Although §1363(b)(2) provides that the deductions referred to in §703(a)(2), including creditable foreign income taxes described in §703(a)(2)(B), are not allowed as a deduction in computing the taxable income of the S corporation, the flush language at the end of §1366(a)(1) specifically confirms that the separately stated items referred to in §1366(a)(1)(A) include creditable foreign tax amounts described in §702(a)(6). Finally, §1363(c)(2)(A) confirms that the §901 election to take a credit, rather than an itemized deduction, for creditable foreign income taxes is made by each shareholder separately, and not by the S corporation. Treas. Reg. §§1.1363-2(c)(iii) and 1.1366-1(a)(2)(iv).

Section 1366(d)(1) provides that the aggregate amount of losses and deductions taken into account by a shareholder under §1366(a) for any taxable year shall not exceed the

sum of (A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to §1367(a)(1) and (2)(A) for the taxable year), and (B) the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder (determined without regard to any adjustment under §1367(b)(2) for the taxable year). Because the flush language of § 1366(a)(1) specifically confirms that the separately stated items of income, loss, deduction or credit taken into account under §1366(a)(1)(A) include creditable foreign income taxes, the basis limitation of § 1366(d)(1) applies to limit the amount of the S corporation shareholder's deduction or credit for its pro rata share of the S corporation's creditable foreign income taxes to the shareholder's basis in its stock at the end of the taxable year.