

Suggested Solutions Corporate Foreign Transaction Chapter

C16-36 a. The U.S. tax liability is \$1,190,000 ($0.34 \times \$3,500,000$). The foreign tax credit limitation is:

$$\$1,190,000 \times \frac{\$1,500,000}{\$3,500,000} = \$510,000$$

Jackson Corporation's foreign tax credit equals \$510,000; that is, the lesser of the \$600,000 foreign income taxes paid or its \$510,000 foreign tax credit limitation.

b. $\$90,000 = \$600,000$ foreign taxes - $\$510,000$ foreign tax credit limitation. The excess taxes can be carried back two years or forward five years. pp. C16-3 through C16-8.

C16-37 a.

Worldwide taxable income	<u>1997-1999</u>
Times: Tax rate	\$1,000,000
Gross U.S. tax liability	x 0.34
1997 foreign tax credit is \$100,000, lesser of:	<u>\$ 340,000</u>

1. $\frac{\$ 400,000}{\$1,000,000} \times \$340,000 = \$136,000$ (FTC limitation)

or 2. \$100,000 (Actual amount paid).

1998 foreign tax credit is \$102,000, lesser of:

1. $\frac{\$ 300,000}{\$1,000,000} \times \$340,000 = \$102,000$ (FTC limitation)

or 2. \$120,000 (Actual amount paid).

1999 foreign tax credit is \$140,000, lesser of:

1. $\frac{\$ 500,000}{\$1,000,000} \times \$340,000 = \$170,000$ (FTC limitation)

or 2. \$140,000 (Actual amount paid).

b. The excess foreign tax credit from 1998 of \$18,000 ($\$120,000 - \$102,000$) is carried back to 1997. The carryback to 1997 eliminates the excess credit amount. No carryovers remain after 1998.

c. Parts a and b would change as follows (assuming the deductions are not allowed to be claimed in calculating the foreign jurisdiction's taxes):

1997 foreign tax credit is \$100,000, lesser of:

1. $\frac{\$ 300,000}{\$1,000,000} \times \$340,000 = \$102,000$ (FTC limitation)

or 2. \$100,000 (Actual amount paid).

1998 foreign tax credit is \$68,000, lesser of:

$$1. \frac{\$ 200,000}{\$1,000,000} \times \$340,000 = \$68,000 \text{ (FTC limitation)}$$

or 2. \$120,000 (Actual amount paid).

1999 foreign tax credit is \$136,000, lesser of:

$$1. \frac{\$ 400,000}{\$1,000,000} \times \$340,000 = \$136,000 \text{ (FTC limitation)}$$

or 2. \$140,000 (Actual amount paid).

The \$52,000 of excess taxes paid in 1998 can be carried back in 1997 where \$2,000 is used. None of the 1998 excess credits can be used in 1999. An additional \$4,000 of excess taxes are paid in 1999. Total excess credit carryovers of \$54,000 (\$52,000 - \$2,000 + \$4,000) remain after 1999. The excess taxes from 1998 can be carried over through 2003. The excess taxes from 1999 can be carried over through 2004. pp. C16-3 through C16-8.

C16-38 Julia can qualify under either the physical presence test or the bona fide resident test. The physical presence test permits Julia to have a larger exclusion in the years of arrival and departure. The qualifying periods for the physical presence test for 1997 through 1999 are calculated as follows:

Qualifying periods:

August 3, 1997 through December 31, 1997	151 days
January 1, 1998 through May 31, 1998	151 days
July 1, 1998 through July 28, 1998	<u>28</u> days
Total	<u>330</u> days

April 10, 1998 through May 31, 1998	52 days
July 1, 1998 through December 31, 1998	184 days
January 1, 1999 through April 4, 1999	<u>94</u> days
Total	<u>330</u> days

Julia's first 12-month period runs from July 29, 1997 through July 28, 1998. It includes 156 days in 1997 that are eligible for the exclusion (July 29 through December 31). Julia's second 12-month period includes April 10, 1998 through April 9, 1999. It includes 99 days in 1999. By combining the days in the two 12-month periods, 365 days in 1998 are eligible for the exclusion. Julia's exclusion is determined as follows:

$$1997: \frac{156}{365} \times \$70,000 = \$29,918$$

$$1998: \frac{365}{365} \times \$72,000 = \$72,000$$

$$1999: \frac{99}{365} \times \$74,000 = \$20,071$$

pp. C16-8 through C16-11.

C16-39 Fred can qualify under either the physical presence test or the bona fide resident test. The physical presence test permits Fred to claim a larger exclusion in the years of arrival and departure. The exclusion for the period 1997 through 1999 is determined as follows:

Qualifying periods:

July 16, 1997 through December 31, 1997	169 days
January 1, 1998 through June 9, 1998	<u>161</u> days
Total	<u>330</u> days
January 1, 1999 through November 26, 1999	<u>330</u> days
January 6, 1999 through December 1, 1999	<u>330</u> days

The 12-month period for the year of arrival is June 10, 1997 through June 9, 1998. The two qualifying periods for the physical presence test in 1999 permit Fred to claim the exclusion for the entire year (i.e., the two 12-month periods include January 1, 1999 through January 5, 2000). In addition, the second 12-month period in 1999 permits Fred to claim the exclusion for five days in 2000, but he has no foreign source earned income to exclude in that year. Fred also qualifies for the exclusion in 1998 under the bona fide resident test. Fred's earned income exclusion for the period 1997 through 2000 is determined as follows:

	<u>Limitation</u>	<u>Earned Income</u>	<u>Exclusion</u>
1997: $\frac{204}{365} \times \$70,000 =$	\$ 39,123	\$ 55,000	\$ 39,123
1998: $\frac{365}{365} \times \$72,000 =$	72,000	120,000	72,000
1999: $\frac{365}{365} \times \$74,000 =$	74,000	110,000	74,000
2000: $\frac{5}{366} \times \$76,000 =$	1,038	-0-	-0-

Fred can exclude all the meals and lodging under the Sec. 119 exclusion (instead of the Sec. 911 earned income exclusion). pp. C16-8 and C16-12.

C16-41 a. U.S. tax liability with rentals taxed as investment income:

Dividend: \$2,500 x 0.30 =	\$ 750
Interest	-0-
Rentals: \$10,000 x 0.30 =	<u>3,000</u>
Total	<u>\$3,750</u>

The tax under this alternative is collected through withholding.

b. U.S. tax liability with rentals taxed as trade or business income:

Dividend: \$2,500 x 0.30 =	\$ 750
Interest	-0-
Rentals: [(\$10,000 - \$7,000 expenses - \$2,750 (1999) personal exemption) x 0.15] =	<u>38</u>
Total	<u>\$ 788</u>

The nonresident alien can claim a single personal exemption but is ineligible to claim a standard deduction. The tax imposed on the dividend income would be collected through withholding. Tien would need to make a Sec. 871(d) election to have the rentals taxed as trade or business income. The tax due on the rentals is collected when the alien's tax return is filed since the \$38 is below the estimated tax threshold. pp. C16-15 through C16-18.

C16-42 a. The dividend income is taxed by the United States as investment income at a 30% rate. The tax owed is \$7,500 (0.30 x \$25,000). A lower tax rate is not available to Pierre unless a tax treaty to which the United States is a party applies. The tax is collected through withholding.

b. The \$25,000 of non-U.S. sales commissions are exempt from U.S. taxation. The \$50,000 of U.S. sales commissions are taxed as being effectively connected with the conduct of a U.S. trade or business. This amount can be reduced by any business expenses and itemized deductions incurred and by a single personal exemption. The taxable income is taxed at the rates applicable to a single taxpayer and collected through estimated tax payments.

c. The capital gain is exempt from U.S. taxation since Pierre was present in the United States for fewer than 183 days in the current year and the gain is not effectively connected with the conduct of a U.S. trade or business.

d. The interest income is not taxed by the United States. pp. C16-15 through C16-18.

C16-47	a.	U.S. source taxable income	\$1,000,000
		Foreign branch income	1,000,000
		Dividend (\$212,500 cash + \$37,500 taxes withheld)	250,000
		Deemed paid credit ^a	<u>83,333</u>
		Gross income/taxable income	\$2,333,333
		Times: Tax rate	<u>x 0.34</u>
		Gross U.S. tax liability	<u>\$ 793,333</u>

$$^a \frac{\$250,000}{\$6,000,000 - \$1,500,000} \times \$1,500,000 = \$83,333$$

Foreign tax credit limitations:

Noncontrolled Sec. 902 foreign corporation = \$793,333 x (\$333,333/\$2,333,333) = \$113,333 Limitation

Other foreign income = \$793,333 x (\$1,000,000/\$2,333,333) = \$340,000 Limitation

Foreign tax credit:

(1) Lesser of noncontrolled Sec. 902 foreign corporation limitation (\$113,333) or foreign taxes paid or accrued on dividend income (\$83,333 deemed paid credit + \$37,500 taxes withheld = \$120,833); plus

(2) Lesser of branch income limitation (\$340,000) or foreign taxes paid or accrued on branch income (\$280,000).

The total foreign tax credit is \$113,333 + \$280,000 = \$393,333.

b. The \$7,500 (\$120,833 - \$113,333) of excess foreign tax credits from the noncontrolled Sec. 902 foreign corporation limitation can be carried back to the second preceding tax year since a \$60,000 (\$20,000 + \$40,000) excess foreign tax credit limitation position exists at the beginning of the current year as a result of prior dividend distributions from India Corporation (the noncontrolled Sec. 902 foreign corporation). The carryback of the excess current year credits to the second preceding tax year reduces the unused limitation to \$12,500 (\$20,000 - \$7,500). A \$40,000 unused limitation remains from the first preceding year.

pp. C16-3 through C16-8 and C16-19 through C16-22.