

Answer-to-Question-_1_

Part 1 of Question 1

A covered expatriate under s. 877A is a US citizen or long term permanent resident, (i.e. green card holder who has been resident in the United State for 8 out of the last 15 years) and who meets the following requirements:

1. Holds net asset in excess of \$2 million at the time of becoming expatriate
2. Has returned income tax in excess of \$124,000 (subject to increases for inflation) each of the previous five years and
3. has not returned the certification of compliance to the IRS (Form 8854).

Katrina has net worth of in excess of \$2 million dollars. Her average net income tax is in excess of \$192,000\$ for each of the preceding 5 years, not including deferred compensation and it is confirmed that she has not filed the form 8854. She has resided as a permanent resident in the USA for the previous 14 consectutive years.

On this basis, Katrina is a covered expatriate.

Part 2 of Question 1

As Katrina is a long-term permanent resident, she is subject to worldwide taxation on her income and assets.

Assets that are not subject to the mark to market regime would include the Nordovan personal pension plan, as foreign located pension are not subject to the s.877A.

Katrina is eligible to claim an exclusion from the mark to market tax charge on her assets on becoming a non-resident covered expatriate of and amount up to (inflation linked) \$600,000 -- this is confirmed to be \$890,000 in 2025.

The mark to market regime will apply to Katrina's US brokerage account. Accordingly, Katrina will be subject to tax on expatriation on the gain of \$300,000.

(Katrina has an option under the s.877A to request a deferral of the tax arising on expatriation on her assets, until such time as her death or the disposal of the assets. This is an irrevocable election and will need to be made on an asset-by-asset basis).

The personal use vacation home in Nordova is subject to the mark to market regime. Accordingly, Katrina will, for the purposes of US taxation, be deemed to have disposed of and reacquired the property at the date of expatriation. It is not clear if this is Katrina's principal residence (i.e. if there is a possibility for the s.121 relief of \$250,000 on the disposal of principal residence would be available). It is assumed that the property was acquired using funds from the USA.

On this basis, the vacation home is subject to s.877A Mark to market (note the possible deferral of tax may be elected on this asset). Tax is applied on the gain of \$190,000

On the unvested deferred compensation, this relates to personal services performed in the US for a US employer (s.861 sourcing). Accordingly, this is US source income. On this basis, the present value of the employment income will be subject to US tax, and included in the computation of the s.877A.

It is not clear if the net asset value of \$2,650,000 is inclusive or exclusive of the assets included in the breakdown below.

On the basis that it is not and that it comprises wholly US assets, the computation of the liability for s.877A is as follows:

Net worth - \$2,650,000
US Compensation - 320,000
Gain on shares - 300,000
Nordovan home gain- 190,000

Total 3,460,000

Less 890,000\$ covered expatriate allowance per s. 877A

Net taxable amount 2,570,000

This is subject to tax at the marginal rates. Note, if Katrina becomes resident within 3 years, she will be subject to US on her income for the intervening period per s. 877.

Part 3 of Question 1

To qualify for treaty benefits under the US MTC, Katrina must establish that she is treaty resident, per Article 4 of the treaty in Nordova in 2026.

It is assumed that Katrina will reside full time in Nordova in 2026 and accordingly will be eligible for treaty benefits.

To claim a treaty position, she would need to ensure (per s.6114, subject to penalties under s.6172 if not undertaken) that she files a Form 1040-NR and Form 8833 by the appropriate filing deadlines.

Under the treaty, employment income is considered under Article 14. It is assumed that Katrina's income is derived from employment is derived from employment carried out in the United States and not in another jurisdiction. It is assumed it is not government service income.

As the employment income is paid by a US employer, Katrina would be unlikely to be able to apply for relief under the treaty per Article 14(2) i.e. income derived from a foreign employer, not related to a permanent establishment.

If any of the employment is contingent on Katrina performing the duties of her employment in Nordova, Katrina may apply to have the proportion of the days spent undertaking services for the US employer to be taxable wholly in Nordova. She may also apply for a credit in her Nordovan tax returns for any taxes deducted in the USA on the compensation, if subject to tax in Nordova on the same income.

Under s. 877A, this deferred compensation is taxable on the point of

expatriation.

Pension income and assets are considered under Article 18. It is assumed that the Nordovan pension fund corresponds to a US pension fund in condition. Article 18 provides that pensions funded from employers in another contracting state may be deductible in the the employment income of that other state i.e. Nordovan pension contributions are deductible in the the USA salary.

Pension funds located in another state are not taxable under s.877A however the relief obtained by Katrina against her US salary on the employer contributions to her foreign pension may be recaptured as part of the s.877A and taxable on the point of expatriation.

Note the relief under s.877A on a per asset deferral of the mark to market tax charge until the disposal of the assets or Katrina's death.

Answer-to-Question-__2

Question 2, part 1

1 (a) CAN Co is a CFC per s.957, as it is a 100% owned foreign subsidiary.

The \$3 million income earned in Canada for services is not CFC Subpart F income as it is subject to the same country exception i.e. not Foreign base service company income.

The \$5 million income earned in Mexico is Foreign Base Services Company income and is subject to the Subpart F regime. It is services carried out outside of the jurisdiction of incorporation of the CFC.

As the Subpart F income is not greater than 70% of the total income of Can Co, then the de maximus rule under s.954 does not apply.

1 (b)

IND co is subject to GILTI regime on the \$38.5 million from the sale of inventory.

As the 1.5\$ million of dividend income is passive income, this is subject to the Subpart F regime.

Under s.954, where Subpart F income is less than 5% of total income and less than 1\$ million in quantum, then it is not considered Subpart F income.

The dividend income is 3.75% of total income but it is greater than \$1 million, accordingly the de minimis requirement is not met under s.954 and it remains taxable as Subpart F income.

1 (c)

The royalty income is deemed to fall within Subpart F income under s. 952, s 954. At 0 \$19 million, it represents 76% of the total income of BRA co in the year. Accordingly, under the de maximus rule of s. 954 the full amount of \$25 million (being \$19 million royalty and \$6 million sale of inventory) is classed as Subpart F income.

Consideration would need to be given as to the breakdown of the royalty income i.e. if any related to services provided as opposed to the licence given. If this is the case, the Subpart F income may be less.

1 (d)

On the basis that SPA co is reselling purchased goods outside of its country of incorporation, then the \$12 million of sales is Subpart F income.

The effective rate of tax on the goods sold is 30%.

The high tax exemption allows that where the effective rate of foreign tax is equal or greater than 90% of the applicable US tax of 21% (i.e. 18.9%), then there is an exception from Subpart F income and then income is treated as not taxable for Subpart F. Accordingly the \$12 million for SPA co is not subpart F as it has an effective foreign tax rate greater

than 18.9%.

Question 2 Part 2

Stream 1 income

It is assumed that AUS co has filed the appropriate forms to recognise the rental income as Effectively connected income in the USA (Form W8 ECI with the Form 1120F). If a treaty position arises, it is important that the appropriate forms 8833 are filed per s. 6114.

Article 6 of the US MTC provides that rental income is taxable in the state in which the property is located in the first instance. Accordingly, the income is taxable in the US. It may also be taxable in Australia.

The income is linked to a trade in the US, it is not clear if this is linked to a permanent establishment in the US per Article 7 of the US MTC (as the US definition of a trade is broader than the US MTC definition of a PE).

Article 22 Limitation of benefits paragraph 3 provides that a resident of Australia may obtain benefits under the treaty if the person is engaged in the active conducted of a trade or business in the US.

It is assumed Aus co is engaged in an active trade and not merely the holding of rental income.

As the income is connected with an active trade in the US, taxed in the US at full marginal rate, therefore Aus Co is entitled to claim the benefit of treaty under Article 22, it is assumed that this income is not subject to Subpart F income.

Stream 2 income

The reduction on the WHT on royalties is accessible to Aus Co under the Article 12 for the US MTC provided that Aus Co meets the qualifications under the Article 22 limitation on benefits.

Article 22 Limitation of benefits paragraph 3 provides that a resident

of Australia may obtain benefits under the treaty if the person is engaged in the active conducted of a trade or business in the US.

Active trade does not consist of the actions of a holding company or the making or managing of investments.

Moreover, paragraph B (1) of Article 22 requires that a benefit is allowed if the rate of tax applied to the income is equal to the rate of tax that would be applied to the income under the treaty in the other state. It is understood that the income from the royalty is not subject to tax in Australia. On that basis, no equivalent tax is applied equal to the US rate. The reduction in the WHT is not not applicable and the US co should treat the income as Subpart F.

Question 2 part 3

F Co is a CFC under s.957 as it is 100% owned by US shareholders.

F Co has a branch in Y country. It is understood no check-the-box election under Form 8832 has been made with regard to Y Branch. Accordingly, it is a look through disregarded entity. Effectively the income earned by Y co is treated as the income of F Co and the Foreign tax credit earned by Y Branch is available 100% to F Co.

F Co purchased goods outside of its jurisdiction and sold to customers outside its country of incorporation via Y Branch. As the income of Y Branch is the income F Co, this income is Foreign Base Sales Company income as it is sales undertaken outside the country of incorporation of F Co. F Co is entitled to claim the tax credit for Y Branch's 12% income tax.

The tax rate in F Co's country of incorporation is 22%. This is greater than 90% of the US federal rate of 21% (i.e. 18.9%). It is assumed that the income of Y Branch will be subject to tax in F Co's jurisdiction, such that, even with the tax credit of 12%, the effective foreign tax on the income will be 22%. In this case, consideration should be given as to whether the income F Co reports as Y Branch income is subject to the high tax exemption and accordingly, not treated as Subpart F income for Mega Co.

This may change if a Form 8832 is filed to recognise Y Branch as a corporation for US tax purposes.

It may also be considered if F Co chooses to treat Y Branch's tax paid as a deduction instead of a credit under s. 164. This may impact on the treatment of any foreign tax credits.

Answer-to-Question-__4

Question 4 part 1

Gross income computation is taxed at a US rate of 21%. (s.1)

Taxable income includes the following:

US Source operating income \$60 million less \$6 million is 54 million net income in the US at 21% US tax rates as it is US source under s. 861/s862.

Foreign branch income - a branch is a disregarded entity, accordingly its income is wholly taxed as the income of the US company and 100% of the foreign tax credit is available. It is not clear whether the income derives from goods manufactured in the US (and would be accordingly US source per s863) or if it derives from the sale of goods where the title passes in the country of the foreign branch and accordingly foreign source income (s.863).

Assuming it is foreign source income, consideration would need to go to the FDII deduction under s.250. As there is no QBAI, the 10% exclusion is not considered. Accordingly, the income of the foreign branch would be subject to a deduction 37.5% .

(\$25 million less 4.5 million) less 37.5% results in taxable income at 21% on \$12,812,500 .

Passive income that is portfolio interest is exempt from taxation under

s.871, s881. This is none taxable and accordingly no FTC is available against this income. The deduction is not taken into account against this income.

GILTI inclusion is subject to a deduction under s. 250 of 50% in 2025. As there is no QBAI, there is no 10% exclusion. Accordingly, income is taxable of \$20 million less SGA of 3 million - \$17 million minus 50% deduction - \$8.5 million

(note the requirement to file form 8993 to claim the deduction under s. 250 for FDII and GILTI)

Deductions are as follows

US Source \$6 million
Branch - \$4.5 million
GILTI - \$3 million
Interest - \$1.5 million

US source taxable income (MILLIONS)

US income - 54 (@21% is tax of \$11,340,000)

Foreign source

Branch FDII - 12.8125 (@21% is \$2,690,625\$)
GILTI - 8.5 (@21% is \$1,785,000)

Total income - 75,312,500
Tax @21% - \$15,815,625

Note, in the case of the Foreign branch income and the GILTI inclusion, it is assumed that the inclusion is inclusive of the S.78 gross up to include the Foreign tax credits paid / deemed paid under s. 960.

Question 4 part 2

The total foreign tax credit is \$15 million. It is assumed that this has been taken into account in the gross income, per the requirements of the s.78 gross up of the income.

The applicable baskets under s. 904 are for FTC under the active income, branch income, passive income and GILTI income.

As the interest is portfolio interest, then, even if the WHT meets the requirements under s. 1442 to be treated as a foreign tax credit for the purposes of US taxation, as the income is not taxable in the US, the FTC will not be available to claim in the passive income basket.

The foreign tax credit is allocable against the income relevant to each basket and limited by the US tax liability applicable to that income, after taking into account any relevant deduction.

The foreign branch income basket is \$8million. This is wholly allowable as it is foreign branch income, and the income is not US source. If the income was US source, the FTC would not be allowable. The income is limited to the US liability on the foreign income.

The GILTI income is subject to the GILTI income basket. The GILTI FTC is capped at 80% of the available tax credit. Accordingly, a FTC of \$4.8 million is available.

Question 4 part 3

Baskets applicable are active, branch and GILTI

branch basket is \$8million. As this is branch income, this is wholly allowable. The FTC is restricted to the branch income basket and may not be offset to other baskets.

Gilti basket is \$6 million x 80% GILTI cap - 4.8 million total allowed
Gilti CREDIT

As the passive income is exempt from US taxation under the portfolio interest exemption, then none of the credit of \$1 million for the WHT is allowable as a credit. The passive income basket is not applicable in

this case.

It is assumed that the taxees charged in the FTC meet the requirements to be considered as taxes under the US tax legislation, ie no benefit received in the other country, effectively equivalent.

Question 4 part 4

Branch income is Foreign source branch income. The tax liability is \$2,690,625. The foreign tax credit is \$8 million. The excess credit is \$5,309,375. This can be carried forward for 10 years for offset against foreign branch income. It cannot be offset against other income in the FTC baskets. It can be carried back one year.

The GILTI income tax liability is \$1,785,000. The allowable FTC after the cap of 80% on the FTC is \$4.8 million. Accordingly, the net liability is nil. The excess credit of \$3,015,000 is eliminated as GILTI credits cannot be carried forward to the following years.

It is assumed that the GILTI inclusion of \$20 million is inclusive of the s.78 gross up of the taxes and similarly for the foreign branch income.

Question 4 part 5

The final USP liability is 21% of the US source operating income as the Branch income and GILTI income have been wholly offset by the applicable foreign tax credits. Liability is \$11,340,000 or 21% of \$54 million

In general, the US does not allow cross crediting under s. 904 to prevent companies from attempting to manipulate the world wide taxation system by offset high-tax active income tax credit for active income against what is deemed to be low tax passive income in other jurisdictions.

Moreover, the cap on credits is to ensure that the relief on taxation is limited to the effective US liability for each income stream.

Answer-to-Question-_6

Question 6 part 1

Domcile is determined on whether there was a continuous presence and links to the USA by Henri over the period of his lifetime.

Henri spent more than 31 days in each year in the USA. This would constitute a habitual abode. Henri did not hold real estate in the US however more than 39 % of his net assets in his estate comprised US assets. That would suggest a strong connection to the US. It is not clear if Henri made a separate will in the US. Henri's family is located in Galvia (his daughter). He does not have a US spouse.

It would suggest that under the US federal code, Henri is not domiciled in the US as he does not have a tax home in the US and does not maintain a habitual abode or close connections to the US, however he would still be subject to US estate tax on his assets situs in the US as they exceed the minimum of \$60,000.

Question 6 part 2

The US treasury bonds are subject to US federal tax as these are sited in the US, being linked to the US treasury. The shares are sited where the bond documents are located i.e. US.

Cash is a fungible asset. In general it is not sited. However, as the cash is held in a US bank account (and it is assumed that it is not the currency of Galvia), it would be deemed a US sited asset.

Shares in public companies are sited where the shares are listed. The shares on the US stock exchange are US sited property.

The Galvia realestate is not US sited property as it is sited in Galvia. The share in the Galvian corporation are not traded on a US stock exhcnage and it is assumed the articles of incorporation are located in Galvia. Accordingly, they are not US property.

US Federal estate tax is computed on the gross value of all US sited assets, gifts made of US assets and income in the US that may be given or that Henri was entitled to receive.

In this case the gross US estate is

Shares \$1,400,000

Bonds \$300,000

Cash \$85,000

Total \$1,785,000

Henri's estate can claim exemptions for charitable gifts and funerary expenses pertaining to the estate. A non-resident alien can also claim relief up to \$60,000 (inflation linked) on US assets for Federal estate . Gifts / assets received obtained pre 1977 are also disallowed from the computation of the estate tax liability.

Federal estate taxes is taxable at 40% on the excess value of US assets after the reliefs allowed.

Question 6 part 3

As Galvia and the US do not have a USMTC estate tax treaty, it may be difficult for Isabelle to obtain relief under the US MTC for US taxes imposed, where there may be a double tax charge in Galvia. If Issabelle files a Form 709 US tax return, or the appropriate estate tax return, she may be able to include a claim for Galvian tax imposed on the worldwide estate.

The Galvia tax allowable in the computation of the US tax liability would be limited to the lower of the value of the follow computations:

1. Galvian tax paid x US sited assets / total worldwide estate assets or
2. Galvian tax paid x US taxation on the estate for US sited assets / US tax on the worldwide estate

This may reduce the US tax liability paid, on the assumption that Galvia will also be taxing the US assets. In the absence of this election,

double taxation will occur on the US assets as it is confirmed there is not a double tax agreement on estate taxes between Galvia and USA.

As a NRA beneficiary, Isabelle will be obliged to file US tax returns for the estate income in the period of administration (either form 1040NR or 1120 F as the estate will be deemed a foreign trust for the purpose of the US tax code). She may also be obliged to register for a US Tax return (Form 1040 - NR)to file a return for the income obtained from the assets she received as part of the estate (i.e. bond income, share dividend income). She would need to file a Form W8BEN to ensure the treaty rate to non-residents would apply to any withholding tax.

As a NRA beneficiary, Isabelle is not entitled to apply the unified credit (\$13.99 million in 2025) against the value of Henri's US estate. As Henri is not a US citizen or resident at the time of his death, this relief will not apply.

Answer-to-Question-8_

Question 8, part 1

The taxable income is

Gross income	85
less operating expenses	(40)
Less interest expenses	(28)
Interst income	3
 Taxable income	 20

Depreciation is not included in taxable income.

Pre allowing for the 163(j) exclusion, the full value of the interest expense is included.

No apportionment for operating expenses.

It is assumed that the interest income is not portfolio interest under s871 / s.881 and is accordingly subject to tax.

Question 8, part 2

Adjusted taxable income for s.163(j) purposes excludes interest income, interest expense and depreciation. Accordingly, the ATI for s. 163(j) is \$45 million. i.e gross income less operating expenses.

Question 8, part 3

per s.163(j), the maximum allowable interest expense is capped at 30% of the adjusted taxable income in the case of corporations where the annual gross revenues exceed \$30million. This is part of the thin capitalisation rules.

30% of \$45 million is \$13.5 million. Accordingly the maximum allowable business interest deduction is \$13.5 million.

Question 8, part 4

The total amount of the interest disallowed is \$28 million less \$13.5 million = \$14.5 million disallowed.

This deduction is available to be carried forward for use against future income of ABC Inc. There will be a restrictive cap on the amount of the offset available in the future years of 90% of the offset amount.