

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2026

MODULE 2.10 – UNITED STATES OPTION

SUGGESTED SOLUTIONS

PART AQuestion 1Covered Expatriate Status

IRC §877A applies to long-term residents who relinquish their green card. A long-term resident is a lawful permanent resident in at least eight of the 15 taxable years ending with the year of expatriation. Katarina has held her green card for 14 consecutive years and therefore qualifies as a long-term resident for §877A purposes.

A long-term resident is a covered expatriate if any one of three tests is met:

- Net worth test: The individual's net worth is \$2,000,000 or more on the date of expatriation. Katarina's net worth is \$2,650,000. She therefore meets the net worth test.
- Tax liability test: The individual's average annual net income tax liability for the five preceding taxable years exceeds the applicable threshold (\$206,000 for 2025). Katarina's average is \$192,000. On the facts given, this test is likely not met on its own.
- Certification test: The individual fails to certify under penalties of perjury (on Form 8854) that she has complied with all federal tax obligations for the five preceding years. Katarina has not filed Form 8854. She therefore fails the certification test and is automatically a covered expatriate regardless of the other tests.

Conclusion: Katarina is a covered expatriate under IRC §877A by virtue of both the net worth test and the certification test failure. Any one test suffices.

Mark-to-Market Calculation

Under §877A(a), a covered expatriate is treated as having sold all property at its fair market value on the day before the expatriation date. The resulting gains and losses are recognised for the year of expatriation, subject to the applicable exclusion amount of \$890,000 (2025).

Assets subject to mark-to-market

US brokerage account (publicly traded equities): FMV \$480,000 less adjusted basis \$180,000 = deemed gain of \$300,000. This is subject to mark-to-market.

Nordovan vacation home: FMV \$340,000 less adjusted basis \$150,000 = deemed gain of \$190,000. Tangible property located outside the US is within the mark-to-market regime unless it falls within a specific exclusion. The personal-use exclusion under IRC §121 does not apply since Katarina is a covered expatriate. The property is subject to mark-to-market.

Total deemed gains subject to mark-to-market: \$300,000 + \$190,000 = \$490,000.

Less exclusion amount: \$890,000.

As total deemed gains of \$490,000 are less than the \$890,000 exclusion, no net gain is recognised under the mark-to-market regime.

Assets excluded from mark-to-market

Eligible deferred compensation items and non-eligible deferred compensation items are expressly excluded from mark-to-market and are instead subject to the deferred compensation rules under §877A(d) (addressed in part 3).

The Nordovan pension is similarly excluded as a non-eligible deferred compensation item or a specified tax deferred account.

Note: The deferred compensation from the US employer is excluded from mark-to-market but subject to withholding treatment on future payments — addressed in part 3.

Mark-to-Market Computation

	\$
US brokerage account — deemed gain	300,000
Nordovan vacation home — deemed gain	190,000
Total deemed gains	490,000
Less: §877A exclusion amount (2025)	(890,000)
Net taxable gain under mark-to-market	Nil

3) Deferred Compensation and Nordovan Pension — Treaty Interaction

US employer deferred compensation (non-eligible deferred compensation): Under §877A(d)(2), non-eligible deferred compensation is subject to a special withholding regime rather than mark-to-market. The covered expatriate must provide notice to the payor, who is then required to withhold tax at 30% on any future payments as if they were FDAP income. The full present value is not immediately taxable; instead, tax applies at the time of actual payment.

The US-Nordova treaty may provide relief under an article equivalent to US Model Article 15 or 18. If the deferred compensation is characterised as employment income under the treaty, the right to tax may be allocated between the US and Nordova depending on where the services giving rise to the compensation were performed. Treaty benefits for covered expatriates are restricted under §877A(f), which provides that a covered expatriate may not claim treaty benefits that reduce the §877A tax to below the amount that would otherwise apply. However, §877A(f) prevents a covered expatriate from using treaty benefits to reduce the §877A charge below the statutory rate. Since §877A(d)(2) is itself the applicable charge, the 30% withholding rate represents a floor and cannot be reduced by treaty in the covered expatriate context.

Nordovan pension (foreign pension plan): The Nordovan employer-funded pension is treated as a non-eligible deferred compensation item under §877A(d)(2) unless it qualifies as an eligible deferred compensation item. An eligible deferred compensation item requires the payor to be a US person or a foreign person who has elected to be treated as a US person for this purpose. Since the Nordovan pension is paid by a Nordovan employer, it is a non-eligible deferred compensation item. The 30% withholding regime therefore applies to future distributions.

Treaty interaction: The US-Nordova treaty Article 18 (pensions) may provide that pension income arising in the US and paid to a resident of Nordova is taxable only in Nordova. However, §877A(f) again limits the extent to which treaty benefits can reduce the expatriation tax charge below the statutory amount. Under §877A(f), the 30% withholding rate represents a floor and cannot be reduced by treaty in the covered expatriate context.

Question 2CAN co: Foreign Base Company Services Income**Relevant rule - Code Sec. 954(e)(1); Reg. §1.954-4(b)(1)(ii)**

Under Code Sec. 954(e)(1), foreign base company services income (FBCSI) arises where a CFC performs technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services satisfying two cumulative conditions:

- 1) the services are performed for or on behalf of a related person, and
- 2) the services are performed outside the CFC's country of incorporation.

Both conditions must be simultaneously satisfied for income to constitute FBCSI.

Services performed in Canada (CAD 3 million)

CAN co performs services within Canada - its own country of incorporation. Condition (ii) is not satisfied. Accordingly, the CAD 3 million of fees earned for services rendered within Canada does not constitute FBCSI and is therefore not Subpart F income. Deferral is permitted with respect to this amount.

Services performed in Mexico (CAD 5 million)

CAN co performs services outside Canada (its country of incorporation), on behalf of USA co, which is a related person within the meaning of the statute. Both conditions are simultaneously satisfied. Therefore, the CAD 5 million of fees for services performed in Mexico constitutes FBCSI and is includible in Subpart F income - deferral is denied with respect to this amount.

Conclusion: Only the CAD 5 million attributable to Mexican services is Subpart F income. The CAD 3 million from Canadian services retains deferral.

IND co: De Minimis Exception**Relevant rule - Code Sec. 954(b)(3)(A); Code Sec. 954(c)**

The first exception under Code Sec. 954(b)(3)(A) is the de-minimis rule. Under this rule, none of a CFC's income is treated as foreign base company income or foreign personal holding company income if the sum of the CFC's gross insurance income and gross foreign base company income for the year (before taking into account any deductions) is less than both: \$1 million, and

5% of the CFC's total gross income for the year.

Both thresholds must be simultaneously satisfied for the exception to apply.

IND co's potentially tainted income = \$1.5 million of dividend income.

Dividends received from unrelated parties qualify as foreign personal holding company income (FPHCI) - a category of Subpart F income under Code Sec. 954(c).

The \$38.5 million from sales of self-manufactured inventory within India is not foreign base company sales income, because IND co manufactured the goods within its own country of incorporation (the manufacturing exception applies).

De minimis test

Since the \$1.5 million of tainted income exceeds \$1 million, the first threshold is not satisfied. Both thresholds must be met simultaneously - failure on either threshold means the exception is unavailable.

Conclusion: IND co. cannot avail itself of the de-minimis rule. The \$1.5 million of dividend income is includible as Subpart F income (as FPHCI) in the hands of USA co. The \$38.5 million of manufacturing income remains outside Subpart F.

Note: A common error is to check only the percentage threshold and conclude the exception applies because \$1.5M < \$2M. Candidates must demonstrate awareness that both thresholds are conjunctive - failure on the absolute \$1 million cap is independently disqualifying.

BRA co: Full-Inclusion Rule**Relevant rule: Code Sec. 954(c)(1)(A)**

The second exception under Code Sec. 954(b)(3)(B) is the full-inclusion rule. Under this rule, all of a CFC's gross income is treated as Subpart F income if the sum of the CFC's gross insurance income and gross foreign base company income for the year (before taking into account any deductions) exceeds 70% of the CFC's total gross income for the year. Once the 70% threshold is breached, even income that would not independently qualify as Subpart F income is swept into the Subpart F net - this is the mirror image of the de minimis rule.

BRA co's gross foreign base company income = \$19 million of royalty income received from related parties. Royalties from related parties constitute foreign personal holding company income.

The \$6 million from sales of self-manufactured inventory within Brazil is not foreign base company income under the manufacturing exception and would not ordinarily be Subpart F income.

Full-inclusion test

$\$19 \text{ million (tainted income)} / \$25 \text{ million (total gross income)} = 76\%$

76% exceeds 70% - the threshold is breached.

Conclusion: Under the full-inclusion rule, BRA co's entire \$25 million of gross income is treated as Subpart F income - including the \$6 million of manufacturing income that would not otherwise be tainted. This reflects a legislative judgment that where a CFC's income is overwhelmingly of an abusive character, administrative and anti-avoidance policy justifies treating the whole of its income as tainted rather than requiring line-by-line analysis.

SPA co: Elective High-Tax Exception**Relevant rule - Code Sec. 954(b)(4); Reg. §1.954-1(d)(2)**

The third exception under Code Sec. 954(b)(4) is the elective high-tax exception. A U.S. shareholder may elect to exclude from Subpart F income any foreign base company income or insurance income that is subject to foreign income tax at an effective rate exceeding 90% of the maximum U.S. corporate income tax rate. The current maximum U.S. corporate rate is 21%, making the applicable threshold:

Classification of SPA co's income

SPA co purchases goods manufactured by USA co (a related party) in the United States and resells them to customers outside Spain. This constitutes foreign-based company sales income (FBCSI) under Code Sec. 954(d)(1) because:

The goods are purchased from a related person (USA co.), The goods are neither manufactured nor sold for use within Spain, and the customers are located outside Spain (SPA co's country of incorporation). Effective tax rate computation:

$\$3.6 \text{ million (foreign taxes)} / \$12 \text{ million (net foreign income)} = 30\%$

Comparison to threshold: 30% exceeds 18.9% - the high-tax exception is available.

Conclusion: USA co may elect to exclude the \$12 million from Subpart F income. The policy rationale is that where foreign tax substantially eliminates the benefit of deferral - because the foreign tax credit would absorb most of the residual U.S. tax - applying Subpart F serves no meaningful anti-deferral purpose. The election is not automatic;

USA co must affirmatively claim it.

AUS co: Fourth Exception — Effectively Connected Income and Its Limitations

Governing Rule: Code Sec. 882(a); Code Sec. 952(b); Code Sec. 954(c)(1)(A); Code Sec. 861(a)(4).

The fourth exception provides that Subpart F income does not include any item of a CFC's income that constitutes U.S. source income effectively connected to the conduct of a U.S. trade or business, because such income is already subject to U.S. federal income tax at the CFC level under Code Sec. 882(a).

Policy rationale: The Subpart F regime is designed to deny deferral of income that would otherwise escape the U.S. tax net indefinitely. Where income is already within the U.S. tax net because it is effectively connected to a U.S. trade or business and taxed at full marginal rates at the CFC level - there is no deferral benefit to deny. Applying Subpart F inclusion on top of existing CFC-level U.S. taxation would produce an unwarranted double imposition of U.S. tax. The fourth exception eliminates this anomaly.

Critical limitation: However, the exception expressly does not apply to effectively connected income that is either:

- Stream 1 — \$8 Million of U.S. Rental Income

The \$8 million of rental income from U.S. commercial real estate is U.S.-source income that is effectively connected to a U.S. trade or business carried on by AUS co.

This income is subject to U.S. federal income tax at full marginal rates at the CFC level under Code Sec. 882(a).

The fact that Australia imposes no tax on this income is irrelevant to the application of the fourth exception - the exception is concerned solely with U.S. tax treatment, not foreign tax treatment.

There is no treaty exemption or reduced rate applicable to this income - it is taxed in full by the United States. The foundational premise of the exception is satisfied: U.S. tax is already being collected on this income at the CFC level. Applying Subpart F inclusion would produce double U.S. taxation without any corresponding anti-deferral justification.

Conclusion: The \$8 million of U.S. rental income qualifies for exclusion under the fourth exception. USA co. does not include this amount in gross income as Subpart F income.

- Stream 2 — \$5 Million of Royalty Income (Treaty-Reduced Rate)

The \$5 million of royalty income paid by USA co to AUSco is U.S.-source income — royalties paid by a U.S. person to a foreign person are U.S.-source income.

Under the U.S.- Australia income tax treaty, the withholding tax rate on royalties paid to Australian residents is reduced from the statutory 30% to 5%. AUS co. therefore pays U.S. tax on this income, but only at the treaty-reduced rate of 5% - far below the full marginal rate.

Conclusion: The \$5 million of treaty-reduced royalty income does not qualify for exclusion under the fourth exception and code section 952(b) can not apply in this case considering the same as FDAP income. USA co. must include this \$5 million in gross income as Subpart-F income - specifically as foreign personal holding company income under Code Sec. 954(c)(1)(A), as it represents royalty income received from a related party.

Foreign base company sales income

The issue is whether the income derived by F Co through its low-tax sales branch in Country Y constitutes Subpart F income under the Foreign Base Company Sales Income provisions of IRC §954(d).

Relevant Law: Branch Rule

Under IRC §954(d)(1), sales income of a CFC may constitute FBCSI if it involves related-party transactions and certain geographic conditions are satisfied in this regard.

Although, a branch is not legally separate from the CFC, IRC §954(d)(2) and Treas. Reg. §1.954-3(b) provide that where a substantial tax rate disparity exists, the branch is treated as a separate subsidiary. This deemed separation creates a related-party transaction for purposes of FBCSI.

The disparity test for a sales branch requires:

- The branch tax rate to be less than 90% of the CFC country rate; and
- The branch rate to be at least 5 percentage points lower.

Application to Facts

CFC country tax rate (Country X) = 22%

90% of 22% = 19.8%

Branch tax rate (Country Y) = 12%

Analysis:

- $12\% < 19.8\%$
- Difference = $22\% - 12\% = 10$ percentage points

Both conditions are satisfied. Therefore, the tax rate disparity test is met.

Accordingly, the sales branch in Country Y is treated as a separate related entity, since:

- Goods are purchased from outside Country X, and
- Goods are sold for use outside Country X,

The income satisfies the geographic conditions of §954(d)(1). Thus, the income constitutes Foreign Base Company Sales Income.

Conclusion: Because the branch rule applies and the statutory conditions of §954(d) are satisfied, the income earned through the Country Y sales branch constitutes Subpart F income as Foreign Base Company Sales Income.

Mega Co. must include its pro rata share of such income currently under §951(a), regardless of actual distribution.

PART BQuestion 3Arrangement A — Ostavia Occupational Pension Plan

Domestic law analysis: Arrangement A is a foreign pension plan for US federal income tax purposes. It is not a US-qualified plan under IRC §401(a). The treatment of a non-US pension plan depends on whether the plan is a 'funded' or 'unfunded' plan for US purposes and how the plan is characterised under §402(b) and §404A.

Under §402(b), where an employer contributes to a trust that is not exempt under §501(a), the employee is taxable on the vested accrued benefit to the extent it is not subject to a substantial risk of forfeiture. Since Dmitri is fully vested, any employer contributions and accrued benefits that are not already taxed become potentially taxable. However, no contributions were made during 2025 and Dmitri did not receive any distributions. The \$18,000 benefit accrual relates to prior service and represents a notional accrual rather than a cash contribution.

Under §404A, a deduction is allowed to a US employer for contributions to a foreign plan, but this provision applies to the employer's deduction rather than the employee's inclusion. For an employee who was previously non-resident and joins a US employer, the treatment of pre-existing accrued benefits under a foreign plan is nuanced. In general, contributions and accruals to a foreign plan in respect of services performed outside the US before the individual became a US tax resident are not immediately taxable on becoming a US resident, provided no distributions are received.

The \$18,000 accrual in 2025 based on prior service does not represent a current cash inflow and under general principles would not be includible in Dmitri's income in 2025 absent a distribution or a vesting event triggering §402(b). Treaty analysis: The US-Ostavia treaty Article 18 equivalent provides that pension income arising in Ostavia and paid to a US resident (Dmitri) is taxable only in the US (the state of residence). Since no distributions were made in 2025, Article 18 does not directly apply to the accrual. However, if the treaty contains a savings clause (as most US treaties do), Dmitri as a US resident may find that the savings clause preserves the US right to tax him on worldwide income regardless of the treaty. The Article 18 benefit would be available on any future distributions from Arrangement A.

Conclusion: No amount is includible in Dmitri's 2025 US gross income from Arrangement A in respect of the \$18,000 accrual, as no distribution was received and no vesting event occurred in 2025. Future distributions will be taxable in the US under domestic law; treaty Article 18 may reduce or eliminate US tax on those distributions depending on the treaty's savings clause and limitation on benefits provisions.

Arrangement B — Personal Savings Account

Domestic law analysis: Arrangement B is a personal savings account funded with after-tax contributions. It is not a foreign pension plan in the traditional sense but rather a personal investment account. Since the contributions were made with after-tax funds, the principal (\$95,000 at 1 January 2025) is not subject to US income tax on distribution. Investment income: The \$6,000 growth in the account during 2025 constitutes investment income (interest, dividends or capital gains depending on the nature of the underlying investments). As a US lawful permanent resident from 1 January 2025, Dmitri is subject to US tax on his worldwide income. The \$6,000 of investment income earned in 2025 is therefore includible in his US gross income for 2025, subject to the character of the income (which will determine the applicable rate — ordinary rates for interest and non-qualified dividends, preferential rates for qualified dividends and long-term capital gains).

The \$12,000 withdrawal: The withdrawal consists of (a) a return of after-tax contributions (basis) and (b) earnings. Using a pro-rata approach, Dmitri's basis in the account at the start of 2025 is \$95,000. The total account value before withdrawal is \$95,000 + \$6,000 = \$101,000. The portion of the \$12,000 withdrawal representing earnings is $\$12,000 \times (\$6,000 / \$101,000) =$ approximately \$714. The remainder (\$11,286) is a tax-free return of basis. Note that the \$6,000 investment income is already included in Dmitri's 2025 gross income when earned (see above). The pro-rata approach to the withdrawal prevents those earnings being taxed a second time on distribution. Including the full \$6,000 on accrual and then treating the entire \$12,000 withdrawal as separately taxable in full would be double-counting.

Treaty analysis: The US-Ostavia treaty Article 18 applies to 'pensions and other similar remuneration.' A personal savings account funded entirely with after-tax contributions by the individual is unlikely to qualify as a pension or similar remuneration for treaty purposes. It does not have the character of deferred compensation for services rendered. Accordingly, treaty relief under Article 18 is unlikely to be available for the investment income or the withdrawal from Arrangement B.

Conclusion: The \$6,000 of investment income is includible in Dmitri's 2025 US gross income. Of the \$12,000 withdrawal, approximately \$714 is taxable as investment income and the balance is a tax-free return of basis. No treaty relief is available under Article 18 for Arrangement B.

Question 4Part 1 – Computation of Taxable Income**Step 1: Total Gross Income**

<u>Category</u>	<u>Amount</u>
U.S. income	60
Branch income	25
Passive income	10
GILTI	20
Total	115

Step 2: Less: SG&A Expenses (15)

Allocated:

<u>Basket</u>	<u>Allocation</u>	<u>Amount</u>
U.S.	40%	6
Branch	30%	4.5
Passive	10%	1.5
GILTI	20%	3

Step 3: Net Income by Basket

<u>Basket</u>	<u>Gross</u>	<u>Expense</u>	<u>Net</u>
U.S.	60	6	54
Branch	25	4.5	20.5
Passive	10	1.5	8.5
GILTI	20	3	17

Step 4: §250 Deduction (50% of GILTI)

$$50\% \times 20 = 10$$

$$\text{Taxable GILTI} = 20 - 10 = 10$$

Since 3 Mill expense already allocated, net GILTI basket income: $17 - 10 = 7$

Step 5: Total Taxable Income

<u>Basket</u>	<u>Net</u>
U.S.	54
Branch	20.5
Passive	8.5
GILTI (after §250)	7
Total Taxable Income	90

Step 6: Pre-credit U.S. Tax

$$90 \times 21\% = 18.9. \text{ Hence, Pre-credit U.S. tax} = 18.9 \text{ million}$$

Part 2 – FTC Limitation Computation**General formula under §904**

FTC Limitation = Pre-credit U.S. tax * Basket taxable income/Worldwide taxable income

$$\text{Foreign Branch Basket} = 18.9 \times 20.5 / 90 = 18.9 \times 0.2278 = 4.30$$

$$\text{Foreign branch taxes paid} = 8$$

$$\text{Allowed FTC (branch)} = 4.30$$

$$\text{Excess credit} = 8 - 4.30 = 3.70$$

$$\text{Passive Basket} = 18.9 \times 8.5 / 90 = 18.9 \times 0.0944 = 1.78$$

Foreign taxes paid = 1

Allowed FTC (passive) = 1

Excess limitation = $1.78 - 1 = 0.78$

(No cross-crediting allowed)

GILTI basket income (post §250) = 7

$= 18.9 \times 7 / 90 = 18.9 \times 0.0778 = 1.47$

Foreign taxes attributable to GILTI = 6

BUT §960(d) allows only 80% creditable: $6 \times 80\% = 4.8$

FTC limitation = 1.47

Allowed FTC = 1.47

Excess GILTI credits (no carry forward allowed) = $4.8 - 1.47 = 3.33$

Total FTC Allowed

<u>Basket</u>	<u>Allowed FTC</u>
Branch	4.30
Passive	1.00
GILTI	1.47
Total FTC	6.77

Final U.S. Tax Liability

Pre-credit U.S. tax = 18.9

Less: FTC = 6.77

Final U.S. tax = $18.9 - 6.77 = 12.13$ million

Summary of Excess Positions

<u>Basket</u>	<u>Excess Credit</u>	<u>Excess Limitation</u>
Branch	3.70	–
Passive	–	0.78
GILTI	3.33 (no carryforward allowed)	–

Total unusable foreign taxes = 7.03 million

Policy Rationale

Section 904 prevents cross-crediting, which would allow taxpayers to: Use high-taxed foreign income (e.g., branch in 32% country) To offset U.S. tax on low-taxed foreign income (e.g., passive or GILTI income)

Congress introduced separate baskets to:

- Protect residual U.S. tax base.
- Prevent blending of high- and low-tax jurisdictions.
- Ensure minimum tax on mobile income (especially passive and GILTI income).
- Discourage artificial income shifting.

The GILTI basket is particularly restrictive because: Only 80% credit allowed. No carry forward permitted.

Designed to impose minimum tax on foreign intangible income.

Final Insight

Effective foreign tax rate on branch income = $8 / 25 = 32\%$ (high-taxed).

Passive income ETR = 10%.

GILTI ETR = 30%, but \$250 reduces effective inclusion base, creating limitation pressure.

Major FTC wastage arises due to separate baskets and expense allocation.

PART C

Question 5

Purpose and Mechanics of Totalization Agreements / Certificate of Coverages it

The United States has entered into totalization agreements (also known as social security agreements) with a number of countries to address the problem of double social security taxation. Without such agreements, individuals who work in a foreign country and remain employed by a US employer may be subject to social security contributions in both the US (Federal Insurance Contributions Act — FICA) and the host country simultaneously. Totalization agreements eliminate this double coverage by assigning the individual to one country's social security system exclusively.

The general rule under US totalization agreements is that an employee is subject to the social security laws of the country where they work (the territoriality principle). However, a key exception applies to seconded or detached workers: where a US employer sends an employee to work in a treaty partner country for a temporary period (typically up to five years, though the exact period varies by agreement), the employee may remain covered exclusively under the US system, provided a certificate of coverage is obtained.

A certificate of coverage is issued by the US Social Security Administration and presented to the host country's social security authorities. The certificate confirms that the employee is covered under the US social security system and is therefore exempt from the host country's contributions. In Marcus's case, the certificate confirms that for the planned four-year secondment, he remains subject to FICA and is exempt from Valorian social security contributions. Bergstrom Inc. continues to pay FICA contributions as normal. Marcus does not pay into the Valorian system.

Extension of the Secondment Beyond Four Years

The original certificate of coverage was issued for a four-year period. If the secondment is extended to 66 months (approximately five years and six months), the original certificate will no longer cover the additional period. The steps that Bergstrom Inc. and Marcus should take are as follows.

First, Bergstrom Inc. should contact the US Social Security Administration as early as possible to request an extension of the certificate of coverage. Many totalization agreements permit extensions for temporary assignments beyond the initial covered period, subject to agreement between the competent authorities of both countries. The US SSA would need to negotiate with the Valorian social security authorities for an exceptional extension.

If an extension is granted, Marcus continues to be covered solely under the US system for the extended period and remains exempt from Valorian contributions.

If an extension cannot be agreed between the competent authorities, Marcus will become subject to Valorian social security contributions for the period beyond the coverage of the original certificate.

Working Days in Keldova — No Totalization Agreement

The United States does not have a totalization agreement with Keldova. Accordingly, the protections afforded by the US-Valoria totalization agreement do not extend to work performed in Keldova.

Under US domestic law, FICA applies to wages paid by a US employer to a US citizen regardless of where the services are performed. Marcus therefore remains subject to FICA in respect of his earnings attributable to the 15 working days in Keldova.

If Keldova imposes social security contributions on individuals working within its territory, Marcus may also be subject to Keldovan social security contributions in respect of those 15 days, resulting in double contributions with no treaty relief available. Whether Keldova imposes such contributions on short-term visitors would depend on Keldovan domestic law.

Marcus and Bergstrom Inc. should seek local advice in Keldova to determine whether domestic exemptions (for example, for short-term visitors below a threshold number of days) might reduce or eliminate the Keldovan exposure.

Question 6Domicile for Federal Estate Tax Purposes

For US Federal Estate Tax purposes, an individual is subject to tax on their worldwide estate if they are a US citizen or if they are domiciled in the United States at the time of death. A non-citizen who is not domiciled in the US (a non-resident alien) is subject to Federal Estate Tax only on their US-situs assets.

Domicile for estate tax purposes is determined under common law principles: a person is domiciled in a place if they are physically present there with the intent to remain permanently or indefinitely. Intent is the key factor. Physical presence alone, however substantial, does not create domicile without the accompanying intent to make that place one's permanent home.

Henri visited the US regularly — averaging 60 days per year — but on business visits only. There is no indication that he intended to make the US his permanent home. He was a Galvian citizen, his personal residence was in Galivia, and his visits were temporary and business-related. On these facts, Henri was not domiciled in the United States at the time of his death. He is therefore a non-resident alien for Federal Estate Tax purposes, and US tax applies only to his US-situs assets.

US-Situs Assets and Federal Estate Tax Calculation

The situs rules for non-resident aliens are set out in IRC §§2104 and 2105:

Shares in a US corporation: Under §2104(a), shares in a US corporation are deemed situated in the United States regardless of where the certificates are held or where the shareholder resides. The NYSE-listed US corporation shares (\$1,400,000) are US-situs property and are included in the US taxable estate.

US Treasury bonds: Under §2105(b), certain US government obligations are excluded from the gross estate of a non-resident alien provided the interest on such obligations would have been portfolio interest exempt from US withholding tax. US Treasury bonds qualify for this exclusion. The \$300,000 in Treasury bonds is excluded from Henri's US taxable estate.

Cash in a US bank account: Under §2105(b), deposits with US banks (including savings deposits) are excluded from the gross estate of a non-resident alien if the deposits are not effectively connected with a US trade or business. The \$85,000 cash deposit is therefore excluded.

Galvian real estate: Real property is situated where it is physically located. Henri's Galvian residence (\$2,100,000) is located in Galivia and is not US-situs property. It is excluded from the US taxable estate.

Shares in a Galvian corporation: Shares in a foreign corporation are not US-situs property under §2104. The Galvian corporation shares (\$650,000) are excluded from the US taxable estate.

Federal Estate Tax Computation

	\$
US-situs shares (US corporation)	1,400,000
Gross US taxable estate	1,400,000
Tax at graduated rates (40% on amounts above the exemption threshold)	See note
Less: unified credit available to NRA (equivalent to \$60,000 exemption)	(\$13,000 credit)

Note: Non-resident aliens are entitled only to a unified credit equivalent to the tax on a \$60,000 exemption (approximately \$13,000), compared to the much larger exemption (\$13,610,000 for 2025) available to US citizens and domiciliaries. This significantly increases the effective estate tax burden for NRA decedents with US-situs assets. The estate tax is computed at graduated rates up to 40% on the taxable estate above \$60,000. On a taxable estate of \$1,400,000 (less \$60,000 = \$1,340,000 above threshold), the estate tax is substantial.

Double Taxation Relief and Isabelle's Position

Double taxation relief: The United States and Galivia do not have an estate tax treaty. In the absence of a treaty, the US does not provide a unilateral foreign tax credit for Galvian inheritance tax paid on the same assets. The estate will therefore suffer both US Federal Estate Tax on the US-situs shares and Galvian inheritance tax on the same asset (since Galivia taxes Henri's worldwide estate). There is no mechanism under IRC §2014 to credit Galvian inheritance tax against US Federal Estate Tax because §2014 only provides a credit for foreign death taxes paid to a country in which the property is situated — if the Galvian tax is based on worldwide assets regardless of situs, a

credit may not be available under the statutory formula. Candidates should note the double taxation exposure and the absence of relief.

Isabelle as NRA beneficiary: Isabelle is a non-resident alien who receives assets from Henri's estate. The US Federal Estate Tax is a tax on the decedent's estate, not on the beneficiary. Isabelle does not have a US income tax obligation on the inheritance itself. However, if she receives US-source income from the inherited US corporation shares (for example, dividends), such income will be subject to US withholding tax at 30% (or a reduced treaty rate if a US-Galivia income tax treaty applies) as FDAP income of a non-resident alien. Isabelle should take advice on any US withholding obligations on future investment income from the inherited shares.

Question 7Statute of Limitations – 3-Year vs 6-Year**Relevant Law**

Under Code Sec. 6501(a), the IRS generally has 3 years from the date a return is filed to assess additional tax. However, under Code Sec. 6501(e), this period extends to 6 years if the taxpayer omits from gross income an amount that exceeds 25% of the gross income stated on the return.

Threshold Calculation

Gross income reported on 2021 return	\$400,000
25% threshold (25% × \$400,000)	\$100,000
Subpart F income omitted	\$120,000

Since \$120,000 > \$100,000, the omission exceeds the 25% threshold.

Conclusion: The 6-year extended statute of limitations under Code Sec. 6501(e) applies.

Expiry Date Calculation

Return filed: October 15, 2022

Add 6 years → Statute expires: October 15, 2028

The IRS must assess any additional tax related to the omitted Subpart F income on or before October 15, 2028.

Where a similar omission exceeding 25% of gross income triggered the 6-year statute, expiring six years after the return filing date.

Effect of Missing Form 5471 on Statute of Limitations**Relevant Law**

The statute of limitations for a return only begins to run when the taxpayer has reported to the IRS the information that the relevant Code sections require pertaining to F Sub. Where a taxpayer fails to attach a required information reporting schedule, the entire return is treated as not having been filed for statute of limitations purposes, and the clock does not start running at all.

Application to US Co

US Co filed its Form 1120 for 2021 on October 15, 2022, without attaching Form 5471 for F Sub. Form 5471 is a mandatory information reporting requirement for U.S. persons who own foreign corporations.

Because the Form 5471 was not attached:

- The 2021 return is treated as never having been filed
- The 3-year statute of limitations has not begun to run on any item on the 2021 return
- This includes items related to F Sub being the income generated from the foreign bank account (As per code section 6501(c)(8)).

Practical Consequence for US Co

As of 2026, since Form 5471 was never filed, the statute of limitations as discussed above for 2021 return remains indefinitely open.

Consequences of not filing Form 5471

Congress enacted IRC § 6038 to curb tax abuses occurring because the IRS was unable to obtain information necessary to evaluate a domestic corporation's interests in, and transactions with, its foreign subsidiaries.

Penalties under IRC § 6038 may apply when a Form 5471 is filed late, substantially incomplete, or not filed at all. For any of these three types of failures, an Initial Penalty of \$10,000 per Form 5471 per year may be assessed. [IRC § 6038(b)(1)]

In addition, a Continuation Penalty of \$10,000 per Form 5471 per year may be assessed for every 30-day period (or fraction thereof) beginning 90 days after US Person was notified that a failure exists. [IRC § 6038(b)(2)] The maximum Continuation Penalty per Form 5471 per year is \$50,000. [IRC § 6038(b)(2)] These penalties may apply per Form 5471 required on an annual basis. Finally, a reduction in foreign tax credits may be applicable; [IRC § 6038(c)].

Hence, the above consequences will apply for not filing Form 5471 in this case.

Question 8Compute Taxable Income Before §163(j)

<u>Particulars</u>	<u>Amount (USD mn)</u>
Gross operating income	85
Add: Interest income	3
Total income	88
Less: Business interest expense	(28)
Less: Depreciation	(12)
Less: Other operating expenses	(40)
Taxable income (pre-limitation)	8

Therefore, taxable income before applying §163(j) = \$8 million.

Compute Adjusted Taxable Income (ATI)

For taxable years beginning after 2021, ATI is computed without adding back depreciation, amortization, or depletion.

ATI is calculated as taxable income computed.

Without regard to business interest expense, Without regard to business interest income, Without regard to NOL deductions and §199A deduction.

Start with taxable income = \$8 million

Add back net business interest expense:

Net business interest expense = $28 - 3 = 25$ million

Thus: $ATI = 8 + 25$; $ATI = \$33$ million

(Note: Depreciation is NOT added back for 2022.)

Compute Maximum Allowable Interest Deduction

Under IRC §163(j):

Allowable deduction = 30% of ATI

Floor plan financing interest (not applicable)

30% of ATI = $30\% \times 33 = \$9.9$ million

Add business interest income = 3 million

Maximum allowable deduction = $9.9 + 3 = \$12.9$ million

Compute Disallowed Interest

Total business interest expense = 28 million

Allowed deduction = 12.9 million

Disallowed interest: $28 - 12.9 = \$15.1$ million

Treatment of Disallowed Interest

Under IRC §163(j)(2):

- The disallowed business interest expense is carried forward indefinitely.
- It is treated as business interest paid or accrued in the succeeding taxable year.
- The carryforward remains subject to the §163(j) limitation in future years.

In brief:

- Adjusted Taxable Income (ATI): \$33 million
- Maximum allowable interest deduction: \$12.9 million
- Disallowed interest: \$15.1 million, carried forward indefinitely