THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2025

MODULE 2.10 – UNITED STATES OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

From: Sarah Whitman
To: Ethan Reynolds
Subject: RE: U.S. Tax Treatment of Your 2024 Property Sales & Rental Income

Dear Ethan,

Thank you for reaching out regarding your 2024 property transactions. Below, I have outlined how your property sales, rental income, and mortgage repayments will be taxed under U.S. law, as well as any reliefs that may be available to you.

Property A – Your Main Home

The sale of your primary residence will be subject to U.S. capital gains tax because, as a U.S. citizen, you are required to report your worldwide income, including real estate sales in foreign countries. However, the U.S. provides relief in the form of the §121 home sale exclusion, which allows you to exclude up to $250,000 of gain from tax as an unmarried filer.

When looking at your gain or loss for U.S. tax purposes, we must convert the amounts into USD at the exchange rates applicable at the time of the transactions:

- You originally purchased the property for VDD 3,500,000, and at the time of purchase, the exchange rate was 8 VDD per USD, meaning your U.S. tax basis was $437,500.
- You sold it for VDD 3,000,000, and at the time of sale, the exchange rate was 4 VDD per USD, meaning your U.S. sale price was $750,000.

This results in a capital gain of $312,500 for U.S. tax purposes. After applying the $250,000 home sale exclusion, your remaining taxable gain is $62,500. This is a long-term capital gain, meaning it is subject to preferential U.S. tax rates.

It is important to note that, while this sale results in a capital gain in the U.S., it is a loss under Veridian tax rules due to the change in exchange rates. Because Veridia did not impose any tax on the sale, no Foreign Tax Credit (FTC) is available.

Property B – Rental Property

The tax treatment for Property B is different because it was a rental property, which means that the home sale exclusion does not apply, and you must report the full capital gain/loss on your U.S. tax return.

- You originally purchased the property for VDD 5,000,000, and at the time, the exchange rate was 5 VDD per USD, meaning your U.S. tax basis was $1,000,000.
- You sold it for VDD 5,800,000, and at the time of sale, the exchange rate was 6.5 VDD per USD, meaning the U.S. sale price was $892,308.

Despite making a gain in Veridia, this actually results in a capital loss of $107,692 for U.S. tax purposes due to the changes in exchange rates.

Additionally, since you previously claimed $80,000 in depreciation deductions, this must be recaptured and taxed as ordinary income under IRC § 1250.

Since capital losses can offset capital gains, you can fully offset the $62,500 taxable gain from Property A using part of your loss from Property B. This means that your net taxable capital gain is reduced to $0.

The remaining $45,192 of capital loss can be carried forward to future years. You can use up to $3,000 per year against ordinary income, which can be applied to your rental income this year.

Rental Income & Deductible Expenses

Since rental income is taxable in the U.S., you must report your VDD 1,000,000 rental income, converted using the average exchange rate of 5 VDD per USD, which means your U.S. taxable rental income is $200,000. However, you can deduct certain expenses related to the rental property:

Since you paid VDD 150,000 in mortgage interest, at an exchange rate of 5 VDD per USD, this converts to a $30,000 deduction.

After accounting for these deductions and the $3,000 capital loss offset, your net taxable rental income is $167,000.

Foreign Tax Credit (FTC) for Rental Income

Since you paid VDD 200,000 in Veridian tax on your rental income, at an exchange rate of 5 VDD per USD, this means you paid $40,000 in foreign tax.

Under U.S. tax law, you may be able to claim a Foreign Tax Credit (FTC) to offset the U.S. tax due on your rental income.

Cancellation of Debt Income (CODI) & Mortgage Repayments

Property A – No CODI

Your mortgage on Property A was repaid in full, meaning that there is no Cancellation of Debt Income (CODI) to report.

Property B – CODI & QRPBI Relief

For Property B, due to exchange rate fluctuations, your final repayment in USD was lower than the amount originally borrowed, which results in Cancellation of Debt Income (CODI) of $207,692.

Because this was a rental property, you can elect to exclude this income under the Qualified Real Property Business Indebtedness (QRPBI) rules (IRC § 108(c)). This means that you will not have to report the $207,692 as taxable income, but your U.S. tax basis in the property would have been reduced had it not already been sold.

Question 2

Part 1

The $20 million of net income from the manufacture of Product X and its resale within the United States is US source income and includable in USCo's tax return.

The $6 million of net income from the manufacture of Product X and its sale to customers in Asia is US source income based on the place of manufacture. It is includable on USCo's tax return however, eligible for the 37.5% FDII deduction which is based on place of final use rather than source of income. USCo will report $3,750,000 US source income from these sales.

However, since the income is US source income, the foreign income tax paid will not be creditable.

The $4 million of net income from the purchase of Product Y and the export sale of Product Y for ultimate use by customers in Asia is foreign source income since title passes in Asia. It is also eligible for a deduction of 37.5% as foreign-derived intangible income (FDII). Since we are told its basis in assets is zero, there is no reduction in the income for qualified business assets, USCo will report $2,500,000 of income. This income and the $1,000,000 foreign taxes paid will be in the general basket for foreign tax credit limitation calculations.

The $2 million of net income from the sale of Product Y by its branch in Dubai, all to customers for ultimate use therein. The title to Product Y transferred to the purchasers in Dubai. This is foreign source branch income. The income, and the $180,000 foreign taxes paid by the branch will go into the branch basket.

The $4 million of income earned by USCo from its purchase of Product Y and its resale to DubCo is foreign source income since title passes in Dubai. It is also eligible for a deduction of 37.5% as FDII. Since we are told to take the assets' basis as zero, there is no reduction in the income for qualified business assets, USCo will report $2,500,000 of income. The income will be in the general basket for foreign tax credit limitation calculations. There were no foreign taxes paid in this income.

The $2 million of income earned by DubCo comprises:

- $800,000 Subpart F income; and
- $1,200,000 of Global Intangible Low Taxed Income (GILTI).

None of the income qualifies for the participation exemption since DubCo has no QBAI.

The Subpart F income is not eligible for the de minimis exception – it is less than $1 million but more than 5% of DubCo's income. There is $728,000 of Subpart F earning and profits (the $800,000 less the 9% taxes). USCo will report $800,000 of Subpart F income after the § 78 gross up. The income and $72,000 of related taxes will go into the active basket.

There is $900,000 of GILTI earning and profits (the $1,200,000 less the 25% taxes). USCo will report $1,200,000 of GILTI after the § 78 gross up. The income is eligible for a 50% deduction to $600,000 and $240,000 (80% of $300,000) of the taxes paid will go into the GILTI basket.

The entire taxable income working has been summarised as follows:

US source income:

- $20 million from the manufacture of sale of Product X in the US
- $3,750,000 from the manufacture of Product X and its export sale to Asia

Foreign Source Income – General Basket $5,800,000:

- $2,500,000 from the purchase of Product Y and its export sale to Asia. (After FDII deduction)
- $2,500,000 from the purchase of Product Y and its sale to DubCo. (After FDII deduction)
- $800,000 Subpart F income from DubCo's resale of Product Y purchased from USCo

Foreign Source Income – GILTI Basket:

- $600,000 of GILTI from DubCo

Foreign Source Income – Branch Basket:

- $2 million from the sale of Product Y by its branch in France

Total Income reported:

- $23,750,000 US source
- $8,400,000 Foreign source

Global Taxable Income: $32,150,000

<u>Part 2</u>

US Source Income:

- There is no foreign tax credit allowable on US source income.
- Therefore, the foreign taxes paid on USCo's $3,750,000 of net income from the manufacture of Product X and the export sale of Product A for ultimate use by customers in Asia is not creditable.

Foreign Source General Basket:

- Even though the foreign source FDII earned by USCo is eligible for the FDII deduction, the foreign taxes paid are creditable in full. There is $5,800,000 of foreign source general basket income.
- US tax on that income at 21% is $1,218,000.
- Under the FTC limitation, this is the maximum amount of foreign taxes which can be credit in the general basket.
- USCo. incurred $1,000,000 of foreign income tax on its purchase of Product B and the export sale of Product B for ultimate use by customers in Asia.
- It incurred no foreign income tax in its sale of product B to DubCo but is deemed to have paid $72,000 ($800,000*9%) of foreign income tax paid by DubCo on its Subpart F income.
- Total taxes paid in the general basket = $1,072,000. As $1,218,000 will is payable. The remaining tax will be payable. The excess credits in the general and GILTI baskets cannot be used to offset the US tax on the branch basket income.

Foreign Source GILTI basket:

- There is $600,000 ($1,200,000*50%) of taxable income in the GILTI basket.
- Only a maximum $240,000 (80% of $300,000) foreign income taxes paid are eligible to be credited.
- The US tax on the GILTI income is $126,000.
- Therefore only $126,000 of the $240,000 of foreign income taxes paid on the GILTI income are creditable.
- The excess expires worthless.

Foreign Source Branch basket:

- The $2 million of branch income is subject to a US tax of $420,000.
- The $180,000 of Dubai taxes paid on this income is fully creditable.
- The excess credits in the general and GILTI baskets cannot be used to offset the US tax on the branch basket income.

PART B

Question 3

To: Internal Tax Advisory Team
From: David Hall
Subject: Tax Implications for Jason Wright: No Treaty vs. US Model Treaty

US Tax Liability Without a Tax Treaty

If no tax treaty exists between the US and Montavera, Jason's US tax liability would be determined under domestic US tax rules, as follows:

Tournament Prize Money:

- US tax law (IRC § 871 & § 1441) imposes a 30% withholding tax on gross US-source prize money for nonresident athletes.
- $600,000 earned in the US is subject to 30% withholding ($180,000 tax).
- No US tax applies to the $1.4 million earned outside the US.
- Jason may elect to file a US tax return and be taxed at graduated rates under IRC § 871(d), but this is not treaty-related.
- Montavera taxes worldwide income based on residency. Since Montavera does not provide a foreign tax credit, Jason also pays 20% tax ($120,000) on US winnings in Montavera, leading to double taxation.

Endorsement Income:

- US-source endorsement income is taxable in the US if linked to services performed in the US (IRC § 861(a)(4)).
- $200,000 related to US promotions is taxable in the US.
- $300,000 from a global brand deal is foreign-source income and not taxed in the US.
- Without a treaty, there is no reduction in US tax.

Appearance Fees:

- US-source appearance fees are fully taxable in the US if Jason performs in the US.
- $100,000 earned in the US is subject to 30% withholding ($30,000 tax).
- Montavera also taxes Jason's worldwide income but does not provide a foreign tax credit.
- He also pays 20% tax ($20,000) in Montavera on US appearance fees, leading to double taxation.

Child Support Payments:

- Jason receives child support from his ex-spouse, who is a UK resident.
- The US-Montavera treaty does not apply because the payments originate from the UK.
- Montavera taxes child support at 10%, and Jason has no relief from either the US or Montavera.

Key issue:

- Without a treaty, Jason is subject to 30% US withholding on US-source earnings, Montavera also taxes these earnings without allowing an FTC, leading to double taxation, and child support remains taxable in Montavera because the treaty does not apply.

US Tax Liability Under the US Model Treaty

The US-Montavera tax treaty, based on the US Model Treaty, modifies Jason's tax treatment as follows.

Tournament Prize Money:

- US Model Treaty (Article 16(1))
- Prize money is taxable in the country where the event occurs (US).
- Withholding tax still applies unless Jason files a tax return.
- Montavera continues to tax worldwide income, but under Article 23 (Relief from Double Taxation), Jason can now claim a foreign tax credit in Montavera for the US tax paid.
- Without the treaty, Jason was taxed twice. With the treaty, he only pays the higher of the two rates.

Endorsement Income:

- US Model Treaty (Article 16(2))
- Endorsement income is taxable in the US if it relates to activities performed in the US.
- $200,000 related to US promotions remains taxable in the US.
- $300,000 from a global brand deal is foreign-source income and taxable only in Montavera.

Appearance Fees:

- US Model Treaty (Article 16(1))
- Appearance fees remain taxable in the country where the event occurs (US).
- Montavera still taxes worldwide income, but under Article 23, Jason can now claim a foreign tax credit in Montavera for the US tax paid.
- Without the treaty, Jason was taxed twice. With the treaty, he only pays the higher of the two rates.

Child Support Payments:

- Jason's child support comes from a UK source, so the US-Montavera treaty does not apply.
- Montavera continues to tax child support at 10%.
- Jason receives no treaty relief.

Key issue:

- The US Model Treaty provides double taxation relief for US earnings by allowing Jason to claim an FTC in Montavera, eliminating double taxation.

<u>US Tax Liability as a US Citizen</u>

US Tax Status:

- Citizen, taxed on worldwide income, regardless of residence or physical presence.

Treaty Considerations:

- The US–Montavera DTA (like the US Model) has a "savings clause" (Art. 1(4)) that lets the US tax its citizens as if the treaty didn't exist, except for limited reliefs (foreign tax credits, certain exemptions). This means treaty protections don't override US taxation of citizens.

US-Taxable Income (Worldwide):

- Tournament prize money: $2,000,000 (US + Montavera + other countries)
- Endorsement income: $500,000 (US events + global deal)
- Appearance fees: $200,000 (US + Montaveran)
- Child support: $100,000, still not taxable under US law
- Total = $2,700,000 of taxable income in the US.

Relief Mechanisms:

- Jason would still pay 20% Montaveran tax on his sports/endorsement/appearance income and 10% on child support (though the US ignores child support).
- As a US citizen, he could claim a foreign tax credit (FTC) for Montaveran taxes paid, but Montavera doesn't allow a credit for US tax, so double taxation remains asymmetrical.
- Foreign earned income exclusion (FEIE) could apply if he meets the physical presence test abroad, but given his high income, the $126,500 (2024) exclusion is minimal compared to $2,700,000.

Question 4

Part 1

As per code section 992(a)(1)(c), an IC-DISC must be a U.S. corporation with a single class of stock that has a minimum par value of $2,500.

More importantly, as per code section 991, an IC-DISC does not incur the regular U.S. corporate income tax. The lack of a corporate income tax on an IC-DISC combined with the qualified dividend rate on a dividend from an IC-DISC results in owners of U.S. pass-through entities saving income tax on a portion of their export income.

In addition to incurring tax on actual dividend distributions, U.S. shareholders are subject to tax on deemed dividend distributions from the IC DISC. The deemed distributions include income derived in excess of the first $10 million of qualified export receipts each year. Therefore, an IC-DISC allows a U.S. shareholder to defer paying U.S. tax on the income derived from up to $10 million of qualified export receipts each year.

Exporters may be of the view that the newly manufactured property as export property, the property can be used equipment or even scrap.

In this regard, there are three requirements (3) for an IC-DISC to receive income from a sale of export property:

- A person other than the IC-DISC must manufacture, produce, grow, or, extract the export property in the United States;
- The export property must be held primarily for sale, lease or rental for direct use, consumption, or disposition outside the United States; and
- The export property must have a minimum of 50% U.S. content.

The IC-DISC may not manufacture the export property. A U.S. person other than the IC-DISC must manufacture the export property (minor assembly is insufficient) in the United States.

Generally, the shareholders of a private U.S. manufacturing entity will form an IC-DISC to benefit from export sales. The IC-DISC will typically receive a commission for the export sales (with a corresponding commission deduction by the U.S. manufacturing entity).

The Code defines property as manufactured within the United States if either:

- the exporter incurs 20% of its conversion costs in the United States (a safe harbor),
- the operations in the United States are substantial and generally considered to constitute manufacturing or
- there is a substantial transformation in the United States.

These three tests are identical to the first three tests to satisfy the manufacturing exception to foreign base company sales income under Subpart F.

As per Reg. 1.993-3(c)(2)(iv), for the 20% safe-harbor, the conversion costs count both direct labor and factory burden, which, for this test only, includes packaging and assembly.

Part 2

Situation 1:

In view of the facts and circumstances and basis the provisions mentioned above, the $20 cost in the United States constitute minimum 20% (25%) of the total COGS of [$60+$20], USACo1 conducts manufacturing under the safe harbor rule.

Even if the cost is below 20%, then if the operations in the United States are substantial and generally considered to constitute manufacturing or there is a substantial transformation in the United States, then also the same can be considered as exports eligible as per relevant provisions in this regard.

Situation 2:

USACo2 separately purchases fabric, buttons, zippers, and lining materials that constitute parts to make jackets. USACo2 employs low-skilled workers and thereby these conversion costs are 18% of the COGS and it can be said that there is not a substantial transformation of the jacket components in the final product, USACo2 has manufactured the jackets only if this assembly process is generally considered to constitute manufacturing.

Situation 3:

The conversion significantly changes the character and use of the raw lumber, constituting a substantial transformation. Therefore, USACo3 has manufactured the finished wooden furniture.

Situation 4:

As the final destination of the product is overseas i.e. outside USA, the benefit of IC-DISC can be available. It is to be noted that affixing a completed product to another does not constitute manufacturing or use. In this regard, it is important to refer decision of Second Circuit Court of Appeals which held in General Electric Co, CA-2, 2001-1 USTC that (i) the airplane industry recognises aircraft and engines as legally distinct and separate and (ii) affixing a completed product to another does not constitute manufacturing or use.

Situation 5:

As per IRC, no more than 50% of the fair market value of export property may be attributable to the fair market value of foreign components imported into the United States. The fair market value of the foreign components is their dutiable value.

In this case, since less than half of the content value comes from foreign-sourced materials, the hardware items meet the content requirement to qualify as export property.

However, if the cost of titanium alloy rises to the extent that it exceeds 50% of the value of the hardware items, the foreign content would be too high, and the products would no longer qualify as export property for IC-DISC purposes.

PART C

Question 5

Part 1

Under US tax law, an individual is considered a US tax resident if they meet either:

1) The Green Card Test; or
2) The Substantial Presence Test (SPT) under IRC § 7701(b)(3).

Green Card Test:

- Michaela does not hold a US green card, so this test does not apply.

Substantial Presence Test (SPT) Calculation:

- The test determines US tax residency based on the number of days spent in the US over three years, using the formula: Current year days + (One-third of prior year days) + (One-sixth of two years prior days).
- Michaela's days in the US:
  - 2024: 140 days.
  - 2023: 180 days.
  - 2022: 150 days.
- SPT calculation:
  - 140 + (180 ÷ 3) + (150 ÷ 6) = 140 + 60 + 25 = 225 days.
  - Since 225 days exceed the 183-day threshold, Michaela is a US tax resident under the SPT.

Part 2

Since Michaela is considered a resident of both the US and Ludora, the US Model Treaty (Article 4) applies to determine her primary residency. The treaty uses the following steps.

Step 1, Permanent Home (Article 4(3)(a)):

- Michaela's only permanent home is in the UK, not the US or Ludora, so this is not determinative.

Step 2, Habitual Abode (Article 4(3)(b)):

- Michaela spends four to six months in the US each year, and thus has a habitual abode in the US in addition to her habitual abode in Ludora. Thus this factor is not determinative.

Step 3, Nationality (Article 4(3)(c)):

- Michaela is a British citizen, not a US or Ludoran citizen.
- Nationality does not resolve the tie.

Step 4, Mutual Agreement (Article 4(3(d))):

- Tax authorities would confirm Michaela's primary residence.

Conclusion:

- Since the treaty tie-breaker favors neither Ludora nor the US, Michaela's tax residence will be determined by mutual agreement between the US and Ludora.

Part 3

If Michaela is a Ludoran tax resident under the treaty, the US Model Treaty modifies the taxation of her income.

Ludoran Salary ($150,000):

- Without the treaty: Fully taxable in the US under the worldwide income rule

- With the treaty: Exempt from US tax under Article 14 (Employment Income) if she did not spend 183 days in the aggregate ending or beginning in the tax year.

US Consulting Income ($40,000):

- Without the treaty: Fully taxable in the US as US-source income.
- With the treaty: Only taxable in Ludora under Article 7 (Business Profits).

US Interest Income ($10,000):

- Without the treaty: Fully taxable in the US under IRC § 871.
- With the treaty: Not taxed in the US under Article 11 (Interest Income).

If Michaela is considered US resident:

- The employment income will have no treaty relief since it is paid by a Ludorian employer.

Consultancy Income:

- Without the treaty: Fully taxable in the US as US-source income.
- With the treaty: Only taxable in Ludora under Article 7 (Business Profits).

Interest Income:

- Without the treaty: Fully taxable in the US under IRC § 871.
- With the treaty: US income paid to a US resident is taxable in the US, and out of scope of Ludora.

Question 6

Part 1

Gift Tax Implications:

- The 2024 annual exclusion for gifts is $18,000 per recipient. Since David gifted $500,000 worth of U.S. stocks to his non-resident alien (NRA) daughter, $18,000 is excluded, and the remaining $482,000 is subject to gift tax.
- As David has made no other lifetime gifts, the $482,000 can be applied against his lifetime exemption of $13.61 million, reducing the remaining exemption available for estate tax purposes.
- David must report this gift by filing Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return, to document the use of part of his lifetime exemption for the gift.

Estate Tax Implications:

- David's estate includes U.S. situs assets (the U.S. stock portfolio) and non-U.S. situs assets (the vacation property in Utopia). As a U.S. citizen, David is subject to U.S. estate tax on his worldwide estate, which includes both types of assets.
- The lifetime exemption is reduced by the $482,000 used for the gift, leaving $13,128,000 available for estate tax purposes when he dies.
- Since David is single, his estate does not qualify for the marital deduction that would otherwise be available for transfers to a U.S. citizen spouse. Therefore, any value in his estate above the exemption amount will be subject to U.S. estate tax when transferred to his NRA daughter.

Part 2

FATCA and FBAR Reporting Obligations:

- U.S. persons must report foreign financial accounts if they meet the thresholds for Form 8938 (FATCA) and FBAR. David's Utopian bank account balance of $350,000 exceeds the FATCA threshold for those living abroad, which is $300,000 at any time during the year. As such, he must file Form 8938 to disclose this account.
- Additionally, since the Utopian bank account balance exceeds $10,000, David must also file an FBAR (Form 114) with the Financial Crimes Enforcement Network (FinCEN).

Reporting of Interest Income:

- The $5,000 of interest income generated by David's Utopian bank account is taxable in the United States and must be reported as part of his U.S. taxable income on his U.S. tax return.

Penalties for Non-Compliance:

- Failure to comply with FATCA reporting can result in penalties starting at $10,000 (indexed for inflation) for initial failure to file, with additional penalties for continued non-compliance.
- FBAR penalties can reach up to $10,000 (adjusted for inflation) for non-wilful violations. Wilful violations of FBAR reporting requirements can incur higher civil penalties, up to the greater of $100,000 or 50% of the account balance at the time of the violation.
- Additionally, wilful violations of FBAR reporting requirements can lead to criminal penalties, including a fine of up to $250,000 and imprisonment for up to 5 years.

Question 7

Part 1

The worldwide taxable income of XYZ Co. for year 2021 is $0 which includes overall domestic loss of $ 400,000 and foreign source income of $ 400,000. The set-off of both the source turns out to be $0 taxable income.

XYZ Co. has paid foreign taxes of $100,000 on foreign source income of $ 400,000 i.e. tax rate of 25%. Normally, the tax payers compute their foreign tax credit limitation using the below mentioned formula:

=pre-credit US tax on worldwide income*foreign source income/worldwide income. The same is in line with provisions contained in code section 904(a) of IRC.

In view of the above, the said amount will not be available as foreign tax credit as there is no pre-credit US tax on worldwide income during the year 2023. The said excess credit of $ 100,000 will be allowed to be carried backward for one year / carried forward for ten years.

Part 2

In 2024, the taxpayer was in overall domestic loss situation. This situation arises when domestic deductions/allocated expenses exceed domestic income. In such situation, US Source loss offsets foreign source income which reduces the ability of taxpayer to claim foreign tax credit. Therefore, as per code section 904(g)(1), in subsequent year i.e. year 2024, the taxpayer may recapture and treat as foreign source income the lower of:

- 50% of taxpayer’s US source income in the next year; or
- overall domestic loss (ODL) of earlier year which has not yet been captured.

Accordingly, the portion as mentioned above would be recharacterised as foreign source income for the purpose of computation of foreign tax credit.

In view of the above, the Global income for year 2024 would be $ 840,000 and pre-credit US tax liability of $176,400 @ tax rate of 21%.

Foreign source income will be recaptured to the extent of $ 200,000 (i.e. 50% of $ 400,000 (US Source income in 2024) or $ 400,000 (unrecaptured ODL).

Accordingly, the foreign source income will stand revised to $ 640,000 [$ 440,000 plus $ 200,000 (recaptured portion)] from $ 440,000.

FTC Limitation of XYZ Co=$ 176,400 * $640,000 (foreign source income) / $840,000 (Global Income) =$ 134,400.
Accordingly, the net US tax liability will be $ 42,000 [$176,400 less tax credit of $ 134,400].

However, the tax consequence as mentioned above may change if XYZ Co opts to claim taxes paid in 2023 as allowable deduction from taxable income because the choice between a deduction and a credit applies to all creditable foreign taxes paid or accrued during the year [Reg. § 1.901-1(c)].

Question 8

Part 1

A U.S. Corporation is a U.S. real property holding corporation if the fair market value of its U.S. real property interests equals 50% or more of the fair market value of the sum of the corporation's following interests:

- U.S. real property interests (including any interest in another U.S. real property holding corporation);
- Interests in foreign real property; and
- Any other property of the corporation that is used or held for use in a trade or business.

By only looking at USA CO's assets, USA CO is not a U.S. real property holding corporation as US real interest. U.S. real interest is less than 50% of total combined net assets i.e. $600,000/$1,300,000=46.15%.

As per code section 897(c)(4)(B) and (c)(5), in order to determine whether a US C Corporation constitutes a USRPH or not, the US C Corporation is treated as owning a proportionate share of the assets of any other corporation it controls and a proportionate share of the assets of any partnership, trust or estate, in which it is a partner or beneficiary.

However, upon adding 25% of Dela Co's net assets, the following turns out to be US real interest of FAB Co's in USA Co:

- A (Cash): $700,000+25% of 400,000 = $800,000
- B (US Real Interest): $600,000+25% of 900,000 = $825,000
- A + B = Total combined net assets = $1625,000 being 50.77% i.e. 50% or more.

Hence, US Co is a U.S. real property holding corporation held by FAB Co. The same will be liable for FIRPTA withholding if sold/disposed by FAB Co.

Part 2

The rule determining whether a U.S. corporation was a U.S. real property holding corporation (USRPHC) at any time during the previous five-year period prevents the trick of stuffing non-real property assets into a U.S. corporation to avoid USRPHC status.

US real property interest held by Moon co was 100% i.e. $15 million.

US real property interest held by Moon co just before selling = 15/30.1=49.83%

Hence, due to five year look back, Moon Co is still a USRPHC even though the stake before sale was 49.83%. Hence, the buyer must withhold 15% of the sales proceeds of $ 30.1 million for $4.515 million.

Buyer (transferee), who is generally the withholding agent, must use Forms 8288 and 8288-A to report and pay to the IRS any tax withheld on the acquisition of U.S. real property interests from foreign persons. The tax to be withheld would be $4.515 million. The seller may make an application to IRS for lower withholding tax. Star Co is required to report the gain from sale of US real property interest its return in the year in which the transfer/sale has taken place.