THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 2.10 – UNITED STATES OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Alkem Co owns 50% in Flem Co. Alkem co is a US Shareholder as it holds at least 10% of Flem Co but not more than 50% of the shares. Hence, Flem Co is not a CFC.

Alkem owns 10% shares of Flex Co and becomes US Shareholder as it owns at least 10%. Flem co owns 51% of Flex co and under the constructive ownership rules, Flem co constructively owns 100% of Flex Co. Thus, as per harmonious reading of § 318(a)(2)(C) and 958(b)(2), Alkem is said to have owned 60% of Flex Co, 10% directly and 50% indirectly via Flem Co i.e. 50% of 100%. As a result, Flem Co is a CFC.

Part 2

As per § 301.7701-3 classification of certain business entities: A business entity that is not classified as a corporation under § 301.7701-2(b)(1),(3)(4),(5),(6),(7) or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this regulation.

The entity classification rules provide that a foreign entity will be either a “per se” corporation and will be treated as a corporation for US tax purposes or an “eligible entity” in which case it can elect to be treated as a foreign corporation or disregarded entity. We are told that FCo is an eligible entity. An eligible entity will default to a corporation if the owners have limited liability or to a disregarded entity if one or more owners have unlimited liability for the debts and obligations of the foreign entity.

We are not told that USCo is legally liable or not for all of the debts of F1.

In such a situation:

- If USCo is legally liable for all of the debts of F1, then it is considered that there is unlimited liability of USCO and in that case it will default to a disregarded entity. Since no check the box election is made, FCo will remain a disregarded entity (a branch of USCo) and will not be a CFC.
- If USCo is not legally liable for all of the debts of F1, then it is considered that there is limited liability of USCO and in that case it will default to a corporation. Since no check the box election is made, FCo will remain a corporation and will be a CFC as it is 100% owned by USCo.

Part 3

As per Reg. § 1.957-1(2)- Any arrangement to shift formal voting power away from United States shareholders of a foreign corporation will not be given effect if, in reality, voting power is retained. The mere ownership of stock entitled to vote does not by itself mean that the shareholder owning such stock has the voting power of such stock for purposes of section 957.

For example, if there is any agreement, whether express or implied, that shareholder will not vote his stock or will vote only in specified manner, or that shareholders owning stock having not more than 50 percent of the total combined voting power will exercise voting power normally possessed by a majority of stockholders, then the nominal ownership of the voting power will be disregarded in determining which shareholders actually hold such voting power, and this determination will be made on the basis of such agreement.

Moreover, where United States shareholders own shares of one or more classes of stock of a foreign corporation which has another class of stock outstanding, the voting power ostensibly provided such other class of stock will be deemed owned by any person or persons on whose behalf it is exercised or, if not exercised, will be disregarded if the percentage of voting power of such other class of stock is substantially greater than its proportionate share of the corporate earnings, if the facts indicate that the shareholders of such other class of stock do not exercise their voting rights independently or fail to exercise such voting rights, and if a principal purpose of the arrangement is to avoid the classification of such foreign corporation as a controlled foreign corporation under section 957.

In view of the above, since DCUS has the discretionary power to replace Ms A and to appoint her successor as manager of F2, the company is a controlled foreign corporation.

Part 4

It is important to refer the provisions of Reg. § 1.958-1 Direct and indirect ownership of stock which are enumerated as follows:

a) In general. Section 958(a) provides that, for purposes of sections 951 to 964 (other than sections 955(b)(1)(A) and (B) and 955(c)(2)(A)(ii) (as in effect before the enactment of the Tax Reduction Act of 1975), and 960(a)(1)), stock owned means:

1) Stock owned directly; and
2) Stock owned with the application of paragraph (b) of this section.

The rules of section 958(a) and this section provide a limited form of stock attribution primarily for use in determining the amount taxable to a United States shareholder under section 951(a). These rules also apply for purposes of other provisions of the Code and regulations which make express reference to section 958(a).

b) Stock ownership through foreign entities. For purposes of paragraph (a)(2) of this section, stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, foreign trust (within the meaning of section 7701(a)(31)) described in sections 671 through 679, or other foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, grantors or other persons treated as owners under sections 671 through 679 of any portion of the trust that includes the stock, or beneficiaries, respectively. Stock considered to be owned by reason of the application of this paragraph shall, for purposes of reapplying this paragraph, be treated as actually owned by such person. Thus, this rule creates a chain of ownership; however, since the rule applies only to stock owned by a foreign entity, attribution under the rule stops with the first United States person in the chain of ownership running from the foreign entity.

In view of this, the reply is as follows:

- Domestic Corporation Y owns 75% of the one class of stock in foreign corporation FCo1. Hence, FCo1 is a CFC as Domestic Corporation Y holds more than 50% in FCo1, FCo1 in turn owns 80% of the one class of stock in foreign corporation FCo2 i.e. 60% and hence, FCo2 is also CFC. FCo2 in turn owns 83.33% of the one class of stock in foreign corporation FCo3.
- FCo1 is considered as owning 80% of the 83.33% of the stock which FCo2 owns in FCo3, or 66.664%. Domestic Corporation Y is considered as owning 75 percent of such 66.664% of the stock in FCo3, or 49.998%. Since Domestic Corporation Y is a domestic corporation, the attribution under this paragraph stops with Domestic Corporation Y, even though, such corporation is wholly owned by domestic Corporation X.

Part 5

FCo's common stock is held as follows:

- FPub, a publicly traded foreign corporations owns 40%;
- Ms T, a US citizen, owns 9%;
- Mr P, a US citizen owns 5%;
- USLP, a Delaware limited partnership owns 36%. P is a 20% partner in USLP. The remaining 80% of USLP is owned by 80 equal partners; and
- USCo, a California corporation owns 10%.

It is to be noted that 60% of the stock of FCo is owned by US persons. It is to be checked whether more than 50% is owned by US shareholders.

To be a US shareholder one must own at least 10% of the foreign corporation by vote or value.

Neither Ms T nor Mr P would appear to be 10% US shareholders.

USLP is a domestic partnership. As per the 2022 Final Regulations for entity treatment, domestic partnership can not be treated as an aggregate for purposes of: 1) determining US shareholder and CFC status under sections 951(b) and 957(a), respectively; 2) applying section 956(c) and (d); 3) applying section 1248; and 4) identifying controlling domestic shareholders. Accordingly, look through approach is required to be adopted. Hence, the 36% held by USLP cannot be considered for determining US Shareholder. The proportionate share of partner Mr P, a US citizen is 7.2% and Mr P also holds 5% which combines to 12.20%. Hence, Mr P is a US shareholder.

CalCo is also a US shareholder as it holds 10%.

Total shareholding by US shareholder is 22.20% (10% Cal Co and 12.20% by Mr P). Hence, F Co is not a CFC.

Part 6

Domestic Corporation A, B and C own 9%, 32% and 10%, respectively, of the one class of stock in foreign corporation FX Co. Domestic Corporation A also owns 10% of the one class of stock in Domestic Corporation C.

For the purpose of determining whether Corporation A is a 10% shareholder with respect to FX Co, 10% interest of the 10% interest of Corporation C in FX Co is owned by Corporation A.

Thus, Domestic Corporation A owns 10% (9%+ 10% of 10%) of the stock in FX Co. Accordingly, A is a United State shareholder with respect to FX Co.

Corporation B and C, by reason of owning, 10% and 32%, respectively, of the stock in FX Co are United States shareholders with respect to such corporation.

For the purposes of determining whether FX Co is a CFC, 1% of the stock in FX Co. directly owned by Corporation C and considered by A cannot be counted twice. Hence, the total holding by US shareholders is determined as follows:

Corporation A:	9%
Corporation B:	32%
Corporation C:	10%
Total:	51%

Hence, FX Co is a CFC in this case.

Question 2

ABC Tax Advisers
July 2020

Dear Sam and Brian

You have asked us to explain the US tax implications for each of you in relation to your US activities. In this letter I will focus on the points you have mentioned: tax residence, dividend, compensation, and general/banking issues.

US tax residence

An individual will be considered US tax resident if they are a US citizen, if they have a green card in the US, or meet the substantial presence test (SPT). The SPT is met if you spend more than 30 days in the US in the calendar year, and spend, on average, more than 183 days in the US counting all of the days in the year in question, one-third of the days in the prior year and one-sixth of the year before that.

Brian

As a non-US citizen without a green card you will only be considered US resident if you meet the SPT. As you spend less than 25 days in the US in any calendar year you do not meet the first limb of the SPT and will not be considered a US tax resident for any of the years in question.

Sam

Until 2021 you will not be a US tax resident as you are not a US resident, did not hold a US green card, and did not spend any time in the US.

In 2022 you have started spending days in the US so we need to consider the SPT. As you were in the US for over 30 days you have met the first part of the SPT. However, your average number of days over the last 3 years do not exceed the 183-day test. Therefore, the SPT test is not met. As you were not a citizen and did not have a green card, you will not be considered US tax resident for 2022.

In 2023 you were granted a green card and will therefore be US tax resident for the entirety of the year and future years unless you give up your green card.

Dividend income

US tax residents are liable to US tax on their world-wide income, whereas non-US residents are liable to US tax only on sources within the US. Payments of Fixed Determinable Annual or Periodic profits (FDAP) are subject to a 30% US withholding tax unless reduced or eliminated under a double tax treaty. FDAP includes dividends from US sources.

Brian

As a non-US tax resident you are liable to US tax only on sources within the US. Any dividends you receive from Trident (USA) Inc, (TUS) will be liable to US withholding tax at 30% under US domestic law.

However, under Article 10 of the treaty between the US and country Z withholding tax on dividends is reduced. Where the recipient is an individual the rate is reduced to 15%.

Benefits under the treaty are restricted under the "Limitation on Benefits" provisions in Article 26. However, in your case, you will be entitled to benefits by virtue of you being an individual in Country Z. Therefore, you will suffer 15% US tax on the dividends, collected via withholding tax.

The US company is obligated to make this withholding and pay the tax to the IRS. Therefore, you should make sure the company has procedures in place to collect and pay this tax. In addition, you should provide the company with a validly completed form W8-BEN in order to certify your entitlement to benefits under the treaty.

You not liable to US tax on any dividends from Trident Consulting Ltd (TCL) in Country Z. This is because the dividends do not have a US source and therefore these dividends will not attract US tax.

Sam

Until 2022 you are taxed in the same way as Brian (set out above). For 2023 you are a US resident, and therefore taxable on your worldwide income in the US. This means that the dividends in 2023 (from both TCL and TUS) will be liable to US tax at graduated rates up to 39%.

The dividends from TUS will be paid without US withholding tax as you are US resident. You should provide the company with a validly completed form W9 to certify that you are a US resident.

The dividends you receive from TCL will be paid net of Country Z withholding tax at 25%, but the treaty between the US and Country Z will reduce this to 15% (Article 10 para 2(b)). As described above, you will qualify for benefits under the treaty by virtue of being an individual.

You will be entitled to claim a credit for the 15% withheld in Z against the US tax on the dividend.

Please note that the country Z dividends must be converted to USD at the exchange rate on the day the dividends are paid.

Compensation

Wages and similar payments for services carried out in the US are (generally) considered a trade or business with a source in the US. Therefore, non-US residents carrying out personal services in relation to employment in the US are taxable in the US. However, either domestic exemptions or a double tax treaty may operate to provide some relief against the US tax.

US tax residents will be liable to US taxes on their worldwide income as described above.

Brian

Your salary of $200,000 in 2022 and 2023 is potentially taxable in the US as you have carried out activities in the US.

The US have a domestic exemption for business visitors to the US. To meet the requirements of the exemption:

- the services must be provided on behalf of a foreign employer;
- you must be in the US for not more than 90 days in the calendar year; and
- your pay for the services must not exceed $3,000.

While you meet the first 2 conditions, on an apportioned basis your pay for the US activities will be greater than $3,000 so the exemption will not apply.

However, the treaty between the US and Country Z provides relief under Article 14. This Article states that a resident of Country Z is taxable only in Country Z, unless the employment is exercised in the US. As you spend some time in the US a portion of your salary would remain taxable in the US.

However, Article 14 para 2 provides further relief: provided you are not present in the US for more than 183 days in any 12-month period, the remuneration is not paid by a US employer, and the remuneration is not borne by a PE the employer has in the US, then the wages are taxable only in Country Z.

As you meet these wider conditions, you will not have any US tax liability in relation to your salary. As noted above, you will meet the limitation on benefits article conditions by virtue of being an individual.

Sam

For 2022, as a non-US resident, you are in the same position as Brian above in relation to your TCL salary from Country Z.

Your salary of $50,000 from TUS will be treated as US source income and taxable in the US. The amount of income taxable in the US will be apportioned based on the time spent in the US. Neither the US domestic exemption nor the treaty exemption will apply because the income is paid by a US employer.

From 2023, when you are US tax resident, you will be taxable in the US on your worldwide income and therefore the salary from both TUS and TCL will be taxable in the US.

Your Country Z salary will also be taxable in the US. You will be entitled to claim a credit for any tax suffered in Country Z on the salary. Note that the Double Tax treaty will not restrict Country Z's ability to tax the income as Article 15 allows Country Z to tax directors fees of a Country Z company.

General company and banking arrangements

There are a few other points which would be worth considering in relation to your business:

Associated enterprises

Article 9 of the treaty applies where “the same persons participate directly or indirectly in the management, control, or capital or an enterprise”. Your two companies will be treated as associated for these purposes. The article requires the profits to the calculated on an arm’s length basis, using transfer pricing principles. You should therefore ensure that the pricing between the two companies is at arm’s length to avoid any adjustments under these provisions.

CFC and PFIC

US taxpayers are taxable on certain income attributable to them from a controlled foreign company. When Sam becomes US resident he is within the scope of the US CFC rules. A company is a CFC if it is controlled greater than 50% by US shareholders (a shareholder owning greater than 10% of the shares). As you own the company 50% it will not be a CFC, however, you should monitor this in the future.

Banking arrangements

There are no restrictions on a US taxpayer being a signatory on overseas bank accounts. However, US taxpayers must file an annual Foreign Bank Account Reporting (FBAR) form with the IRS. Penalties for failing to submit a timely FBAR start at $10,000 and are limited to 50% of the highest balance on the account at any time in the year.

FATCA

In addition, US taxpayers may become reportable under FATCA in relation to their non-US assets and investments.

We trust the above is helpful and will be happy to provide any further information that you requires.

Yours sincerely
ADIT Candidate

PART B

Question 3

Part 1

As per § 367(b) of IRC, USA Co. will have to recognise the dividend income of $10 million. The said dividend income should be exempt from US corporate tax due to the dividend received deduction under code section 245A.

The USA Co will have to recognise the gain of $ 2 million ($14 million less $12 million) and USA co will have a carryover basis of $14 million in the assets distributed.

Part 2

This is the situation wherein the transfer of property by US person to a non-corporate foreign entity is involved.

As per code section 704(c) of IRC, where a United States person contributes appreciated property to a foreign partnership, the foreign partnership will allocate any gain on distribution of the appreciated property to that US Person.

Furthermore, as per Reg. § 1.721(c)-1(b)(14), if the contribution of appreciated property is to a foreign partnership that the US Person and related foreign partners own more than 80%, the US person will immediately recognise gain if the foreign partnership does not adopt a specified gain deferral method that recognise a portion of gain each year during the property's recovery period.

In this case, in view of the above provisions, Alpha Co. will have to recognise $10 million gain on the above-mentioned transfer of property.

If Alpha co and F Sub put together owns only 70% of FRAN & Co., a France partnership, Alpha co will not recognise the gain until the property is sold by the partnership. In this above-mentioned situation, the partnership would allocate the proportionate gain of $7 million (70% of $10 million) gain on property's pre-contribution increase to Alpha co.

Part 3

As per code section 367(a)(1) read with Reg.§ 1.367(a)-3(a), generally the outbound toll charge rules recast a transfer of shares or securities by a US Person to a foreign corporation in an otherwise tax-free reorganisation as a taxable sale.

A limited exception applies however if the reorganization meets certain requirements.

The policy underlying the limited interest exception is that when the US persons who owns shares of the transferred US target receive only a small stake in the acquiring foreign corporation, the outbound tool charge should not apply because there is a little chance to avoid U.S. tax the following are the five requirements for limited interest exception:

1) The US person transferring the shares of US target received 50% or less of the shares of the acquiring foreign corporation in exchange.
2) There is not a control group of US persons with respect to the acquiring foreign corporation immediately after the transfer i.e. under this control group test US directors, US officers and 5% or greater shareholders of the US corporation may not, in the aggregate, own more than 50% of the voting power or value of the acquiring for incorporation immediately after the transfer.
3) The transaction satisfies the active trade or business test outside the United States for 36 months and neither the US transferors nor the acquiring foreign corporation intend to discontinue or dispose of the trade or business of the acquiring foreign corporation.
4) The US transferor who owns 5% or more of the acquiring foreign corporation immediately after the exchange must enter into a five-year gain recognition agreement.
5) The value of the acquiring foreign corporation is, at the time of the exchange, equal to or greater than the value of the US target.

In view of the above, the reply is as follows:

1) Mr X & Ms Y who are U.S. citizens receive 50% or less of Iceberg a UK corporation.
2) As Mr X & Ms Y are the only shareholders officer or 5% shareholder of You Corp, there is not a US control group which owns more than 50% of Iceberg, that is Mr X & Ms Y owns only 4.5% of Iceberg.
3) Iceberg has operated more than 36 months and both Mr X & Ms Y and Iceberg intend to continue the business.
4) Due to stake of only 4.5%, no five-year gain recognition agreement is required to be filed.
5) The value of acquiring foreign corporation is quite higher than the value of acquirer.

In view of the above, Mr X & Ms Y shall not recognise gain because of satisfying the limited interest exception criteria as mentioned above.

Part 4

As per code section 368(a)(2)(E), this entire structuring is considered as tax-free forward triangular reorganization where the foreign corporation forms another US corporation i.e. acquirer company and then the said US acquiring company will get US target merged with it and the ultimate shareholders of US target will receive shares of foreign corporation.

Congress enacted the outbound toll charge of § 367(a), in part, to tax shareholders who transfer appreciated shares of US Corporations for shares of foreign corporations because this transfer may represent the US Treasury's last opportunity for taxing the appreciation.

Despite the fact that the rules provide for an outbound toll charge by considering the foreign corporation as if it were not a corporation, concern arose over whether the rules were detrimental enough to discourage so-called corporate inversion transactions.

Tax treatment for US shareholders for shares received from H Co.

As per § 367(a) of IRC, the Uni Corp (US C Corporation) will not report any income on this transaction, the former shareholders of Uni Corp should recognise capital gain to the extent that the fair market value exceeds basis in Uni Corp's shares. In this case, FMV of H Co' shares is $ 90 million and basis in Uni Corp's shares is $ 10 million and accordingly, the difference of $ 80 million of gain will be taxed to the concerned US Shareholders.

Tax treatment of transfer of shares of FOR Co to H Co. by Dela Co.

In view of code section 902 read with code section 1248 of IRC, the capital gain will arise to Dela co on sale of shares of FOR Sub and the said tax on capital gain may be offset by foreign tax credit for taxes paid in FOR sub' country of residence.

Income received (post inversion) by FOR sub

FOR sub will remain no longer the CFC as per subpart F chapter. As a result, its income will never result in US Tax. Finally, assuming that FOR sub and H Co are outside United States and accordingly, now will be required to pay tax in their country of residence only and not in USA.

Impact of § 7874 of IRC

Congress enacted the § 7874 anti-inversion rules to limit the US Tax benefits of corporate inversions by providing different methods of taxation.

More explicitly, the anti-inversion rules apply if:

i) the US corporation either becomes a subsidiary of a foreign corporation or transfers substantially all its property to a foreign corporation,
ii) US shareholders own 80% or more of the shares of the foreign corporation because of the inversion transaction,
iii) the group doesn't have substantial business activities in the foreign corporation's country of incorporation has compared to the aggregate worldwide business activities of the group.

As per Reg. § 1.7874-3(b), substantial business activities result when the foreign corporation's country of incorporation encompasses 25% of the group's assets, employee compensation and income.

In view of the above, it is to be noted that:

i) the former Uni corp shareholders own 80% or more of H Co;
ii) Uni Corp transfers substantially all its property to H Co; and
iii) the Group of H Co., Dela Co (the acquirer company) which acquires Uni Corp and FOR sub does not have substantial business activities of the group.

As a result of not satisfying condition for substantial business activities of the group, H Co is considered as if it were a US Corporation that will incur tax on its worldwide income. The US shareholders of former Uni Corp will not have to recognise gain under the outbound toll charge. Income of FOR Sub may be subpart F income of H Co, which was and remains CFC for the purpose of US Taxation.

Question 4

Part 1

Bill is US tax resident by virtue of being a US citizen. Stellar Finance Ltd (Stellar) is a non-US corporation. It could be treated as a controlled foreign corporation (CFC), but as Bill holds less than 10% of Stellar he will not have to include any income under Sub-part F or under the Global Intangible Low Taxed Income (GILTI) regime.

Stellar could be treated as a Passive Foreign Investment Company (PFIC). A foreign corporation will be treated as a PFIC if either (a) 75% or more of its gross income is passive income (interest, dividends etc); and/or (b) at least 50% of its assets generate passive income or are held for the purpose of producing passive income. Stellar meets both these criteria as all of its income consists of passive income (interest) and all its assets are held to generate interest income. It will therefore be treated as a PFIC.

As Stellar made no distributions during Bill's ownership he will not have any tax liability for 2022 or 2023. If Stellar had made distributions, these would be taxed as "Excess Distributions" if the total for the year exceeded 125% of the average distributions received from Stellar in the previous three tax years.

When Bill sells the shares in 2024, the gain of $185,000 will also be treated as an Excess Distribution under the PFIC regime: the gain is apportioned to the tax years in which Bill held the shares (i.e. 2022 to 2024). The portion relating to 2024 is taxed at Bill's marginal rates, and the portion relating to earlier years is taxed at the highest marginal income tax rates for each year. In addition, Bill will be deemed to receive annual interest, on a compounding basis, for the years 2022 and 2023.

Finally, Bill will not be entitled to claim any foreign tax credit for the tax paid by Stellar in years 2022 to 2024.

Part 2

Bill could utilise one of the following elections:

- Mark-to-Market Accounting Method. If this election is made, Bill will be taxed each year he holds Stellar, based on the growth in value for that year. Bill must calculate the gain based on the market value of Stellar at the end of each calendar year. The profit for each year will be taxed at Bill's marginal income tax rate, avoiding the disadvantage of being taxed at the highest rate, and avoiding the compound interest charges.
- Qualified Electing Fund ("QEF") Election. If this election is made Bill should include his proportionate share of the income and gains received by Stellar in his taxable income for each year of ownership. Under this regime the income/gains of the PFIC retain their nature, so Bill is treated as receiving ordinary income if the PFIC receives income, and as receiving capital gains if the PFIC receives capital gains. Any income is taxed at Bill's marginal tax rates, avoiding the disadvantage of being taxed at the highest rate, and avoiding the compound interest charges. Capital gains attributed from the PFIC may be taxed at capital gains tax rates.
- Stellar could elect to be treated as a partnership for US tax purposes by filing an entity classification form (a 'check-the-box' election). Note that this will require the company to make the election rather than Bill, and will affect all US shareholders of Stellar, therefore the company will need to consider other investors' requirements. If the election is made, Stellar will be treated as a partnership for US tax purposes and Bill will need to include his proportionate share of the income and gains received by Stellar in his taxable income for each year of ownership. Similar to the QEF regime, the income/gains retain their nature for tax purposes which will result in Bill being taxed at his marginal tax rates on income and at capital gains tax on gains, thus avoiding the disadvantage of being taxed as the higher rate and avoiding the compound interest charges.

Part 3

The elections are made using the following forms:

- Mark-to-Market Accounting Method (Form 8621).
- QEF Election (also Form 8621). To make this election Bill must ensure Stellar is able to provide him with an annual statement describing the ordinary income and capital gains it has generated.
- Entity Classification Election (Check-the-box, Form 8832). The form must be made within 75 days of Stellar's incorporation for the election to have effect from incorporation.

PART C

Question 5

The Inflation Reduction Act, P.L. 117-169, was signed into law on Aug. 16, 2022. The act imposes a 15% corporate AMT (CAMT) based on the adjusted financial statement income (AFSI) of an applicable corporation. The corporate AMT will apply to tax years beginning after 31 Dec 2022.

The basics of the corporate AMT under the act state that an applicable corporation's AMT is equal to the amount by which the tentative minimum tax exceeds the sum of the corporation's regular U.S. federal income tax liability, plus its liability for the base-erosion and anti-abuse tax.

The corporation's tentative minimum tax is a 15% tax on its AFSI for the tax year (computed considering financial statement net operating losses (NOLs)), to the extent it exceeds the corporate AMT FTC for the tax year.

In addition to the corporate AMT FTC, corporations are eligible to claim a tax credit for corporate AMT paid in prior years against regular income tax, to the extent regular tax exceeds the tentative minimum tax for such tax year.

FTC under Corporate AMT

The alternate minimum tax is reduced by foreign tax credits if the applicable corporation chooses to claim an FTC for the tax year. The corporate AMT FTC is the sum of:

1) Foreign income taxes (within the meaning of Sec. 901) paid or accrued by an applicable corporation; and
2) The lesser of:

    a) The amount of foreign income taxes (within the meaning of Sec. 901) taken into account on the applicable financial statement of each CFC and paid or accrued by the CFC for U.S. federal income tax purposes; or
    b) The applicable corporation's pro rata share of the CFC AFSI adjustment multiplied by 15%.

Thus, foreign income taxes paid or accrued by CFCs are subject to a limitation.

The limitation = the applicable corporation's CFC AFSI adjustment x 15%

However, foreign income taxes paid or accrued directly by a domestic corporation, such as withholding taxes or the taxes paid on income of a foreign activity conducted directly by the corporation, are not subject to a limitation.

Foreign income taxes are taken into account for purposes of the corporate AMT FTC only if a two-prong test is met (i.e., the foreign income taxes must be taken into account on the relevant applicable financial statement and be paid or accrued, for U.S. federal income tax purposes, by the relevant corporation).

Carry forward of foreign tax credit

Excess corporate AMT FTCs attributable to CFCs may be carried forward for five years.

As drafted under the law, the corporate AMT FTC carry forward appears to apply only to CFC-level foreign taxes in excess of the CFC-specific limitation, rather than global foreign taxes in excess of the overall corporate AMT liability. As a result, it does not appear that any foreign income taxes paid or accrued directly by a domestic corporation would be allowed as a carry forward. The corporate AMT FTC does not include any limitations under Sec. 904 – such as separate category income or loss, overall foreign loss, overall domestic loss, or loss recapture provisions – in determining the credit. Additionally, it is not determined on a country-by-country basis, nor does it matter if taxes paid by CFCs are deemed paid or attributable to inclusions under Sec. 951 or 951A.

In view of the above, the situation-wise reply is provided as follows:

Situation 1

It is trite law that the taxes paid by CFC1, 2 and 3 shall be eligible as taxes paid as defined under code section 901 i.e. foreign income taxes that are (1) income taxes within the meaning of Sec. 901; (2) taken into account on the applicable financial statements; and (3) paid or accrued for federal income tax purposes by CFC1, 2 and 3.

Acme's corporate AMT FTC is the lower of:

- the pro rata share of the foreign income taxes ($240 million); or

- 15% of the CFC AFSI adjustment (15% of $500 million + $300 million, or $200 million).

Thus, even though aggregation of CFC1,2 and 3's foreign income taxes is allowed, Acme is granted only $150 million of a corporate AMT FTC in the current year. The remaining $90 million of taxes paid by CFC1/2/3 are carried forward for up to five years.

Situation 2

The taxes paid by foreign branches shall pass through the following tests:

1) income taxes within the meaning of Sec. 901;
2) taken into account on the applicable financial statements; and
3) paid or accrued for federal income tax purposes by Uncle Sam co.

Thus, both the branches' foreign income taxes are assumed to qualify for the corporate AMT FTC. Because both the branches are foreign branches of Uncle Sam Co, no limitation applies on the foreign income taxes paid by both the branches.

Corporate AMT liability = $450 million x 15% = $67.5 million

Foreign tax credit= $75 million +$30 million = $105 million

Thus, Uncle Sam Co. is allowed to claim the entire $105 million but only to the extent of $67.5 million and accordingly, the CAMT will be nil in this case and the unutilised tax credit of $37.5 million lapses as there is no provision to carry forward such credit.

Question 6

Part 1

Regular Tax Liability and BEAT

The US branch of F Co has made taxable income of $ 30 million ($350 million less $320 million of royalty). The said income is subject to tax at 21%. Regular tax liability is $6.3 million.

The Branch has made base erosion payments in excess of 3%. The US branch has average turnover of $500 million in preceding 3 years ($390 million for year 2020 + $500 million for year 2021 + $610 million for year 2022 = $1,500 million / 3 years = $500 million [§ 59A(e)(1)(B)].

The US branch will be subject to BEAT i.e. the tax is referred to as a base erosion and anti-abuse tax (BEAT).

The BEAT is the difference between the BEAT rate times the modified taxable income less the regular US corporate income tax (Applicable tax rate 10% x modified taxable income).

Modified taxable income = Taxable income without deductions for:

i) payments to foreign related parties that are not subject to withholding; and
ii depreciation on property purchased from related parties.

However, said base erosion payments do not include the purchase of inventory from a related person. So, payment of $50 million for purchase of inventory will not be included as base erosion payments.

BEAT Liability

Regular taxable income	$30 million
Add: Base erosion payments	$320 million
Modified taxable income	$350 million
Tax rate	10%
Tax liability @ 10%	$35 million
Less: regular tax liability at 21%	$6.3 million
BEAT liability	$28.7 million

Overall US tax liability = $35 million [$28.7 million BEAT and $6.3 million regular tax liability]

Part 2

If the gross receipts are $300 million, the gross receipts test of minimum $500 million will not be satisfied (i.e. $300 million + $500 million + $610 million = $1,410 million / 3 years. $470 million. Due to the above, BEAT will not apply.

Regular US tax liability: $30 million of net taxable income will be subject to tax at 21%. $6.3 million will be the final tax liability.

The foreign parent may be able to claim the above-mentioned tax as deduction from final tax liability in the country in which it is domiciled based on domestic tax law and treaty between both the countries, if any.

Question 7

Income from US real property interests by non-US residents is considered Fixed Determinable Annual or Period ("FDAP") income. FDAP is liable to US withholding tax at 30% unless reduced by either domestic law or under the terms of a double tax treaty with the US.

A taxpayer may elect under IRC section 871(d) that income from US real estate is treated as income effectively connected with a US trade or business ("Effectively Connected Income" or "ECI").

Profits/gains on the sale of US real property interests are also treated as ECI. In addition, the disposition may be liable to withholding tax under the Foreign Investment in Real Property Tax Act ("FIRPTA"). US tax is withheld at 15% of the gross proceeds of sale by the buyer of the real property interests.

Mr T

The rent received by Mr T is considered FDAP. He will be liable to US withholding tax at 30% of the gross rent received with no deduction for expenses.

Mr T can elect under s871(d) to treat the income as ECI. He will then be taxed at graduated rates on the net income receives (i.e. after deduction of expenses). This is likely to be more tax efficient for Mr T but will require him to file annual tax returns (form 1040NR) with the IRS.

On sale, as a non-US taxpayer, he will be required to pay US tax at graduated rates on the profit realised as this also constitutes ECI.

He will be liable to withholding under FIRPTA at 15% of the gross proceeds (15% x $1.8m = $270,000). As the gain on sale is $300k, the tax withheld will likely exceed Mr T's US tax liability and he will be entitled to claim a tax refund. He will need to file a US tax return to report the gain and obtain the refund.

Alternatively, Mr T could reduce the amount of FIRPTA withholding by obtaining a FIRPTA certificate from the IRS. Mr T should file a form 8288-B with the IRS prior to the date of sale and notify the purchaser of the application. Mr T can calculate the maximum amount of tax payable on the sale (based on graduated rates) and, if accepted, the IRS will issue a certificate to the buyer to withhold the lower (maximum) amount entered on the application. This does not reduce the tax payable but removes (or reduces) the need to apply for a refund from the IRS.

Mr T may also be liable to tax in country T on the capital gain realised. He may be able to claim a credit for the US tax suffered under the applicable laws in Country T.

Apollo Holdings

Apollo Holdings LLC is a US LLC with one owner. In the absence of any elections it will be treated as a disregarded entity for tax purposes. Therefore, Mr S is treated as receiving the rental income and the gain on sale direct for US tax purposes.

In the same way as Mr T, Mr S will be liable to US withholding tax at 30% on the gross rents received. He can elect to treat the income as ECI and be taxed at graduated rates on the income. He will also be liable to FIRPTA withholding at 15% on the gross sale proceeds unless he follows the procedures outlined above for Mr T to obtain a FIRPTA certificate. Even though the seller is a US entity, FIRPTA applies to single-member LLCs with a foreign owner.

Alternatively, Mr S could elect for Apollo Holdings LLC to be treated as a corporation for US tax purposes. The rental profit and gains on sale would then be taxed at US corporate tax rates in the company, which are generally lower than personal taxes.

If Apollo distributes the net profits to Mr S as dividends this will be treated as FDAP and liable to US withholding tax at 30%. However, the treaty between the US and Country S will reduce the rate of withholding to 15%. Mr S will qualify for the benefits under the treaty as he meets the limitation on benefits provision as an individual.

Mr S may be taxable in country S on the dividends he receives but may be entitled to a credit for the US tax withheld at source.

Question 8

Part 1

Bluestar Advisors PLC (“Advisers”) is a UK company. As all members have limited liability (and no members have unlimited liability) it is considered a corporation for US federal tax purposes.

Bluestar Trading Strategies Management Ltd (“Trading”) is a Cayman company. As all members have limited liability (and no member have unlimited liability) it is also considered a corporation for US federal tax purposes.

Bluestar L.P. (the “LP”) is a Cayman Limited Partnership. As some members have limited liability, but some members do not, it is not considered a corporation. As it has more than one member it will be considered a partnership for US federal tax purposes.

Part 2

Advisors is a foreign corporation. As Gretchin owns 100% of the shares in the company it will be treated as a controlled foreign corporation (“CFC”) in relation to Gretchin%. He must include 100% of any sub-part F income or Global Intangible Low-Taxed Income (GILTI) in his US taxable income.

An entity is considered a Passive Foreign Investment Company (“PFIC”) if:

- it has greater than 50% of its income from passive sources; or
- it holds greater than 50% of its assets to generate passive income.

Advisors does not appear to receive passive income or hold assets for the generation of passive income, so will not be a PFIC. In addition, generally if a company is a CFC it cannot also be a PFIC.

Trading is a foreign corporation. As Gretchin owns 100% of the shares in the company it will also be treated as a CFC (and not a PFIC) for Gretchin in the same way and for the same reasons as Advisers.

The LP is a partnership and therefore cannot be treated as either a CFC or a PFIC for Gretchin (either directly, or indirectly via Trading).

Part 3

Advisers is a corporation. Under IRC Regularion 301.7701 a UK PLC is treated as a per se corporation. Its classification cannot be changed and it will remain a corporation, and therefore a CFC, for Gretchin.

Trading is a corporation. As it is not a per se corporation, the company could file form 8832 Entity Classification Election to change the classification. As the company has only one member (i.e. Gretchin), the entity can be changed from a corporation to a disregarded entity.

If the election is made, the entity will cease to be a corporation and therefore will cease to be a CFC for Gretchin. It will also continue to not be classified as a PFIC.

The LP is a partnership. It is not a per se corporation and could therefore file form 8832 Entity Classification Election to change the classification. The entity could elect to be treated as a corporation for US tax purposes.

If this were done, the entity would not be a CFC for Gretchin as we are told there all members are non-US taxpayers, therefore there would be no US shareholders. The entity may become a PFIC for Gretchin assuming it is receiving passive income or holding assets to generate passive income.