PART A

QUESTION 1

Expat US Tax Consulting LLC
June 11, 2025

Dear Ethan Reynolds,

You requested that we provide you tax advice on your US tax obligations with regards to the sale of your two properties in Veridia.

As per IRC 7701(a) and 7701(b), a US citizen is taxable on their worldwide income as the US tax system is based on citizenship. As you are a US citizen, you will be taxable on your worlwide income which needs to be reported on your Form 1040. Your rental income needs to be reported on Sch E of your Form 1040 and a Form 8858 will also be required as it is considered a separate and clearly identified business or trade which maintains its own books and records. The sale of your properties will be reportable on your Sch D of your Form 1040.

<u>Property A - your main home</u>

-You purchased the property in March 1999 for VDD 3,500,000.

-You sold it in August 2024 for VDD 3 million.

- You had a VDD interest only mortgage on the property for VDD 3,150,000. In 2024 you paid VDD 100,000 in mortgage interest.

- You repaid the mortgage in full at the time of sale.

At first it may look like you incurred a loss of VDD 500,000 when you sold the property as the purchase price was VDD 3,500,000 and the sale price was VDD 3 million. From a US perspective, in order to ascertain the actual profit or loss, we need to first convert the sale and purchase price to USD from VDD. The gain or loss would be classified as long term capital gain/loss as you held the property from 1999 to 2024. There would be no tax due on the sale if you incurred a loss. However,

if it results in a profit, you would be eligible for the Sec 121 exclusion which would wipe off $250,000 (as you are filing as single) of your capital gains income from sale from being taxed as you met the ownership test and the use test as you owned and lived in the property for atleast 2 years out of the last 5 years. We need to calculate your sale price and purchase price in USD using the spot rates on the date they were bought and sold to arrive at the net capital gain or loss.

Purchase price in USD = USD 437,500 (3,500,000/8)
Sale price in USD = USD 750,000 (3 million/4)

Total profit = Sale price less cost price = USD 312,500

Now based on your 'Single' filing status, under the Sec 121 exclusion, USD 250,000 of this profit would not be taxed as you met the requirements.

The remaining USD 62,500 would be taxed at the long term capital gains rate and this would be sourced to foreign as passive income. If you paid foreign tax on the sale of this property in Veridia, then you can claim FTC to reduce or offsett your US income tax liability on this income.

Under Sec 987, foreign currency gains are taxable under US law and would be reported as other income on your Form 1040. This would not be covered under the Sec 121 exclusion. As you had a VDD denominated, interest only mortgage on the property, we need to calculate the mortgage settlement gains on the sale of the property. The VDD 100,000 of mortgage interest cannot be used here but it can be converted to USD and used as an itemized deduction if you are considering itemizing your deductions on Sch A rather than taking the standard deduction.

Amount of mortgage = VDD 3,150,000
Value of mortgage when borrowed in USD = USD 393,750 (VDD 3,150,000/8)

Value of mortgage when sold = USD 750,000 (3 million/4)

Mortgage settlement gains = USD 750,000 - USD 393,750 = USD 356,250

Your long term taxable capital gains = USD 62,500
Your mortgage settlement gains = USD 356,250

Property B - Rental Property

-You bought the property in July 2008 for VDD 5 million and rented it out continuously.

- You had a interest only mortgage in VDD, for VDD 4,500,000 which you repaid in full on the date of sale.

- In 2024, you received VDD 1 million in rental income on which you paid VDD 150,000 in mortgage interest and VDD 200,000 in Veridian tax.

- Over the years, you have claimed USD 80,000 in total depreciation for the property.

Your rental income of 1 million VDD needs to converted to USD and reported on your Form 1040 Sch E. The mortgage interest you paid of VDD 150,000 needs to be converted to USD and taken as an expense item to reduce your net rental income. Depreciation can also be claimed against your rental property until Dec 2024 when it was sold. The foreign tax you paid needs to be converted to USD and can be claimed as foreign tax credit which will help in reducing or offsetting your US income tax liability.

Similar to the above scenario, any foreign currency gains earned when the mortgage is settled, under Sec 987 would also be taxable.

Your rental income in USD = 166,667 (VDD 1 million / average exchange rate of 6)

Your rental expenses in USD = 25,000 (VDD 150,000/6)

Your net rental income = rental income in USD less rental expenses (including depreciation). Here the depreciation deduction for 2024 is not stated clearly.

Net rental income (before accounting for 2024 depreciation) = USD 166,667 - USD 25,000 = USD 141,667

Your sale of the rental property would not be eligible for the Sec 121

exclusion as you did not meet use test. Hence, the capital gains on the sale will be a taxable event. There will be no tax due if the sale results in a loss.

Purchase price of property = 1 million USD (VDD 5 million / 5 - spot date on the date it was bought)

Sale price of property = USD 892,308 (VDD 5.8 million/ 6.5 - spot rate on the date it was bought)

Depreciation claimed = USD 80,000

The depreciation claimed over the years will reduce the cost price or the basis of the property as the benefit of annual depreciation was taken when you reported your rental income each other. When the property is sold, the depreciation claimed over the years needs to be captured back. Hence, the 80,000 USD will reduce your basis.

Purchase price in USD = 1 million USD less 80,000 = USD 920,000

Net capital loss on sale = USD 920,000 - USD 892,308 = USD 27,692

Now we need to calculate if there was any gain on the mortgage settlement transactions.

Value of mortgage when purchased = USD 900,000 (VDD 4,500,000/ 5 - spot rate when purchased)

Value of mortgage when sold = USD 692,308 (VDD 4,500,000/6.5 - spot rate when mortgage was settled)

As there is a loss on the mortgage settlement of USD 207,692 this would not be a taxable event and the mortgage settlement loss cannot be claimed on your US tax return.

I hope these answers your queries.

Best regards,

Ankurita

QUESTION 2

1.USCo is a domestic corporation headquarted in the US and formed in the state of California. As per IRC 7701(a) and 7701(b), a domestic US corporation will be taxable on their worlwide income.

How much taxable income must USCo report on its US tax return?

- $20 million of the net income from the manufacture of Product X and its resale within the US is taxable income.

- $6 million of net income from the manufacture and export of Product X for ultiate use by customers in Asia is taxable income. However, this would qualify for the FDII (Foreign Derived Intangible Income) deduction as the Product X was sold for ultimate use for customers in Asia. There would not qualify for participation exemption as the basis of all assets is zero and no relevant parties have incurred interest expense. This income would qualify for the 37.5% deduction under FDII bringing the effective tax rate down to 13.125%. The FDII deduction is to promote US corporation to keep their intangibles in the US.

FDII Deduction =

(Deduction Eligible Income - 10% of tangible business assets) * (foreign derived deduction eligible income/deduction eligible income)

FDII deduction is 37.5% of $6 million as there is no basis in assets. Therefore the deduction is $2,250,000.

The remaining $3,750,000 is taxed at the US corporate rate of 21%.

- The $4 million of net income from the Purchase of Product Y and sale

to customers in Asia would be taxable income. However, this income is also qualified for the FDII deductio as it was sold for ultimate use by customers in the foreign countries. No participation exemption available as there is no basis in assets.

FDII deduction is 37.5% of $4 million. Therefore $1.5 million will not be taxed and can be repatriated without paying tax.

The remaining $2.5 million would be taxable at 21% US corporate rate bringing down the effective tax rate to 13.125%.

- $2 million of net income from the sale of Product Y by its branch in Dubai would be taxable income. This would not qualify for the FDII deduction as the sale is made by the branch and not USco directly.

- The $4 million of net sale of Product Y to DubCo at arms length price is taxable income to USco. However, this income would be eligible for the FDII deduction as the sales were for ultimate use for customers in dubai and Asia. There is no participation exemption available as there is no basis in assets.

FDII deduction is 37.5% of $4 million. FDII deduction is 37.5% of $4 million. Therefore $1.5 million will not be taxed and can be repatriated without paying tax.

The remaining $2.5 million would be taxable at 21% US corporate rate bringing down the effective tax rate to 13.125%.

- DubCo is a CFC as it owned by USco. A foreign corporation is controlled foreign corporation if more than 50% of the foreign corporation is owned by US citizens, by vote or by value. Post the TCJA, due to the anti deferral regime, income from CFC classified as Subpart F or GILTI income are also taxable to the US shareholders.

<u>What is the source (US or foreign) of such income?</u>

<u>US Source Income</u>

- $20 million of the net income from Product X and its resale within the US is US sourced income as Product X was manufactured and sold in the

US. No FTC is available on the income.

- $3,750,000 of the income is US sourced income as Product X was manufactured in the US, therefore according to the sourcing rules, this would constitute US sourced income and FTC paid on this income cannot be claimed against this income.

Foreign Sourced Income

- The $2.5 million of income from the sale of Product Y would constitute foreign sourced income as the Product Y was purchased from an unrelated US corporation and title transferred in foreign countries. As this is foreign sourced income, foreign tax credit can be claimed on this income.

- The $2 million of net income from the sale of Product Y by branch in Dubai is foreign sourced income as it the sale is via the branch in a foreign country.

- The $2.5 million of income from the sale of Product Y to Dubco would constitute foreign sourced income as the Product Y was purchased from an unrelated US corporation and title transferred in foreign countries. There is no foreign tax credit available on this income as USco paid no foreign taxes.

- Dubco's sale of Product Y to customers in Dubai would be GILTI income. Therefore, $1,200,000 of the income would be GILTI income. Dubco's sale of Product Y to customers in India would constitute Subpart F income, as the product Y was sold and manufactured outside Dubco's country of incorporation.

2. How much FTC can USco claim?

USco can claim foreign tax credit on the foreign tax paid on the foreign sourced income. This would help in reducing or offsetting USco's income tax liability. However, there are certain restrictions when it comes to claiming FTCs. There are 4 baskets of FTC - general, passive, branch and GILTI. Cross crediting between these branches is not allowed as it would likely blend the high taxed income with the low taxed income. However, blending between different countries but within the same FTC basket is

allowed for US income tax purposes. The FTC that can be claimed is limited by a formula -

(a) Calculate the amount of foreign taxed paid

(b) Calculate the amount of pre-determined US tax liability on this income

(c) FTC allowed is the lesser of (a) and (b)

Any excess FTC can be carried back 1 year or forward 10 years.

General basket

- USD 900,000 (15% of $6 million) of FTC is available from the $6 million of net income from the manufacture and sale of Product X. Even though the income is US sourced, the general FTC can be used against other foreign general limitation income.

- USD 1 million (25% of $4 million) of FTC is available from the sale of product Y.

- The USD 800,000 of sale to customers in India would constitute Subpart F general income and would be taxed at 21%. Since the tax rate in India is 25% compared to the 21% US corporate rate, it may be beneficial to claim FTC on this income so that the excess FTC can be claimed against other low taxed income within the same basket, or be carried back 1 year or forward 10 years.

Branch basket

- The $2 million of net income from the sale of Product Y by branch in Dubai is foreign sourced income as it the sale is via the branch in a foreign country. FTC paid is USD 180,000. All of the FTC can be claimed against the branch income.

GILTI basket (Sec 951A)

- Dubco's sale of Product Y to customers in Dubai of $1.2 million is GILTI income. According the GILTI regime, this income would receive the

Sec 250 deduction. Hence, only 50% of the $1.2 million i.e. $600k will be taxable for GILTI purposes at the US corporate rate of 21%. Therefore, US tax due on this income will be USD 126,000. Dubco paid taxes of USD 108,000 (9% of $1.2 million) in Dubai. It can claim FTC of 80%. Therefore USD 86,400 of FTC can be claimed against this income. This will not qualify for participation exemption as the basis in all assets is zero. The remaining US tax due on this income is USD 18,000 (USD 126,000 - USD 86,400).

PART C

QUESTION 5

1. Michaela is a UK citizen. She is not a US long term resident and does not hold a Green Card. Therefore, Michaela will not be considered a US tax resident unless she meets the substantial presence test. The substantial present test is a 2 limb test which can be met if -

(1) atleast 31 days in the US in the currentt year

(2) total number of US presence days in current year + 1/3rd of the US days in the prior year + 1/6th of the US days in the pre-prior year = 183 days

She would meet SPT for 2024 under domestic US law, if both the limbs of the test is met.

Now for 2024, she meets the first limb of SPT as she spent 140 days in the US during 2024.

Now using the lookback rule

= 2024 US days + (1/3rd of 2023 US days) + (1/6th of 2022 US days)

= 140 + (1/3*180)+(1/6*150)

= 140+60+25
= 225 days

Under the domestic laws, Michaela is considered a US tax resident in 2024 since she met SPT.

2. Michaela is treated a Ludoran resident under Ludora's tax law. Her tax home is in Ludora as her principal place of work is in Ludora, even if she is a UK citizen.

She met SPT in 2024 as she spent 225 days in the US using the SPT calculation.

She spent less than 183 days in each of the years in the US, so she qualifies for the closer connection exception under domestic laws because -

- she spent less than 183 days in the US in the year
- has a tax home in the foreign country
- has a closer connection to the foreign country.

However, under the closer connection exception, her US sourced income would still be taxable to her for her US workdays.

Under Article 4(3) of the treaty tie breaker, she shall be deemed to be resident only of the contracting state in which she has a permanent home, where her personal and economic relations are closer and where she has a habitual abode. Article 4(3) is usually applied when the individual spends more than 183 days in the US during the current year and when closer connection exception does not work.

However, since she has a work contract in Ludora, and is treated as a Ludoran resident, she can claim the Article 4(3) of the treaty benefits

and not be considered a US tax resident even if she spent more than 183 days in the US.

3. Ludora has a Double tax agreement with the US, similar to the US model convention.

She has the following sources of income in 2024 -

- $150,000 salary paid in Ludora
- $40,000 from US consulting work, perfomed remotely for a US based client.
- $10,000 of US interest income from a US bank.

Ludora would not meet the domestic commercial traveller exception as she spent more than 90 days in the US during 2024 and also likely earned more than $3,000 of compensation from services performed.

Under Article 14(2)of the US and Ludora income tax treaty there is a much wider commercial traveller exception available which ould exempt her US sourced personal service income from being taxed if she was working under a foreign contract for a foreign employer with no permanent establishment in the US and also spent less than 183 days during the 12 month consecutive period.

If she meets the above requirements, she can exempt all of the PSI income from US income tax using Article 14(2) of the treaty. There is no limit to the amount of PSI that can be exempted using the treaty.

The $40,000 of the US consulting work would be taxable in the US and would not be exempt by the Article 14(2) of the treaty as the income is paid by a US based client. Since, this is consulting work, we need to look at Article 5 - Permanent Establishment of the treaty if that applies. This would likely be considered a PE as she has the right to conclude the work done for the US based client. Therefore, this $40,000 of the consulting income would be taxable to her. PSI income for a non resident is usually FDAP. However, she may receive a Form 1099- NEC (non-employee compensation) from the US based client. She needs to file a Form 1040-NR and report this income which will be then taxed at

graduated rates and the excess withholding (if any) can be refunded back to her.

The USD 10,000 of interest income is US sourced income as it is paid from a US bank account. However, under domestic laws this would qualify for the portfolio exemption and no withholding will be made on this income. She does not have to pay tax on the interest income from the US bank.

QUESTION 8

1. A US real property holding corporation is a domestic corporation. 50% or more of the assets should be US real property for it to qualify as a US real property holding corporation for US tax purposes. A USRPH corporation is subject to FIRPTA (Foreign Investment in Real Property Tax Act). Capital gains on sale of personal property is usually sourced based on the residency of the seller. However, this mostly applies to stocks and securities. For US real properties, FIRPTA rules come in where the income from the sale of US real property is treated as Effectively connected income to the US, and 15% of the gross value of the real property (if valued over $1 million) is withheld by the purchaser.

Now lets check if USA Co, is USRPHC -

Delaco is a US C-corporation owned 25% by USACo. Delaco is a USRPHC as it is a US corporation and 50% or more than Delaco's assets consits of US real property. The cash of $400,000 is not counted when calculating the basis of the assets.

USA Co Assets are as follows -

<u>Real property</u>

US real estate through USCo = $600,000

US real estate through DelCo = $225,000 (25% of $900,000)

Therefore, USA Co is a US real property holding corporation as all of the assets held directly and indirectly by USCo is considered as US real property which would then be subject to FIRPTA rules.

Cash of $700,000 is disregarded when calculating the basis of assets for FIRPTA purposes. Reason being that any corporation can inflate its non real property assets by contributing more cash to the business which would then reduce the percentage of the real property asset holding.

2. MoonCo is a US C corporation whose only asset during the last 5 years comprised of US real estate of $2 million with a FMV of $15 million.

Moonco is a USRPH corporation as it is a US corporation and 50% or more of the assets are US real property, therefore subject to FIRPTA rules.

The cash contributions of $15,100,000 by Star Co in Moon Co is disregarded when calculating the basis of assets for FIRPTA purposes. Reason being that any corporation can inflate its non real property assets by contributing more cash to the business which would then reduce the percentage of the real property asset holding.

The fair market value of the US real property at the time of sale is USD 15 million. The purchaser needs to withhold 15% of the gross proceeds i. e. 15% of $15 million = $2.25 million USD based on FIRPTA rules.

PART B

QUESTION 3

Expat US Tax Consulting LLC
June 11, 2025

Dear David,

You requested a memorandoum regarding Jason's US tax liability in the absense of a DTA.

Jason is not a US citizen as he does not hold a green card and is not considered a long term resident of the US. Therefore, for US income tax purposes, Jason will only be considered as a US tax resident, if he meets the substantial present test which is a 2 limb test.

Limb 1 - atleast 31 days of US presence in the current year
Limb 2 - total current year US s + 1/3rd of prior year US days + 1/6th of pre-prior year US days should be equal to 183 or more

Limb 1 is not satisfied as Jason was present in the US for 30 days during 2024. Hence we do not need to look at Limb 2. Jason is not considered a US tax resident in 2024. However, a non resident will be taxable on their US sourced income in the US and not on their worldwide income.

<u>Jason's US tax liability in the absense of a DTA</u>

As a non-resident Jason will only be taxable on his US sourced income in the US.

In the absense of a DTA, the $600,000 from tournaments in the US would be taxable in the US according to US sourcing rules. However, this income could potentially be exempt from tax if he contributed the money towards recognized US charities as there is a exemption under domestic laws for sports players.

The endorsement income of $500,000 from the US based sportswear company would be taxable in the US as it is US sourced income paid by a US

company.

The $100,000 for competing in the US Open Tournament would be taxable in the US as it is US sourced income as the services were performed in the US.

The $100,000 for competing in the Montaveran Open Tournament would be foreign sourced income as the services were performed in the foreign country, therefore not subject to US income tax.

The child support payments totalling $100,000 is also foreign sourced and not taxable in the US as it is paid by his ex-wife who is a UK citizen and resident. Therefore, for a US nonresident, the US does not have the right to tax this income.

Jason needs to file a Form 1040-NR to report his US sourced income.

Jason's US tax liability in the presence of a DTA

Jason's US tax postion if he were a US citizen, rather than a UK citizen

As per IRC 7701(a) and 7701(b), a US citizen is taxable on their worldwide income as the US tax system is based on citizenship. If Jason is a US citizen, he will be taxable on his worlwide income which needs to be reported on his Form 1040.

Article 1(4) of the savings clause preserves the right of the US to tax its citizen as if the treaty did not exist. Therefore, as a US citizen, he would not be able to take a treaty exempton on his income.

Therefore, he would have to include his worldwide income on his Form 1040.

Tournament prize money of $2million would be
taxable to him. $600k would be US sourced and the $1.4 million would be foreign sourced. He can claim the FTC on this income subject to FTC limits.

The $500k of endorsement income would be taxable to him. $500k would be US sourced and no FTC would be available on this income.

The appearane fee of $200,000 would be taxable to him out of which $100k would be US sourced and $100k would be foreign sourced. He can claim FTC on this income subject to his pre-determined US tax limit based on his level of income.

The child support payments totalling $100k would also be taxable to him as foreign sourced income. He can claim FTC on this income.

I hope these answers your queries.

Best regards,

Ankurita