**Home work-Chapter 13.**

**This homework has been updated for Spring 2017.**

**Current year is 2016.**

**Introduction to U.S. Taxation of Global Income**

The United States income tax system (that is applicable to its citizens & domestic corporations) is:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | a world-wide system | **b.** | a territorial system |  |

[Sec. 7701(a)(4) and (5), Sec. 1442 ]

Which of the following types of income is not subject to income tax by the United States?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Company Information** | **Type of Income** | **Earned in What Country?** |  |
| **a.** | Domestic Corporation | Manufacturing Income | China |
| **b.** | Foreign Corporation | Manufacturing Income | China |
| **c.** | Domestic Corporation | Rental Income | China |
| **d.** | Foreign Corporation | Rental Income | United States |

**Territorial System**

Bud is citizen of United States. Bud worked in U.S. from January 1, 2016 through June 30, 2016.   
He then moved to the U.K., where he worked for the last 6 months of 2016.   
He earned $100,000 in first 6 months in the United States.   
He earned $100,000 in last 6 months while working in the U.K.   
Assume all income is taxable (no deductions allowed in either country).

The U.S. income tax rate is 40%. The U.K. income tax rate is 35%.

**Assume each country has a tax system that is territorial in scope.** What is the total income tax Bud will pay for 2016 in both countries? (Ignore state income tax.)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $70,000 | **c.** | $75,000 | **d.** | $80,000 | **e.** | $115,000 |  |

**World-wide System and Double Taxation**

Bud is citizen of United States. Bud worked in U.S. from January 1, 2016 through June 30, 2016.   
He then moved to the U.K., where he worked for the last 6 months of 2016.  
 He earned $100,000 in first 6 months in the United States.   
He earned $100,000 in last 6 months while working in the U.K.   
Assume all income is taxable (no deductions allowed in either country).

**The U.S. income tax rate is 40%. The U.K. income tax rate is 35%.**

**Assume each country has a tax system that is world-wide in scope for its citizens**. There is no provision for limiting double taxation of income (no foreign tax deduction or credit -- and no exclusion of foreign earned income).   
What is the total income tax Bud will pay for 2016 in both countries? (Ignore state income tax.)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $70,000 | **c.** | $75,000 | **d.** | $80,000 | **e.** | $115,000 |  |

**World-wide System and Foreign Tax Deduction**

Bud is citizen of United States. Bud worked in U.S. from January 1, 2016 through June 30, 2016.

He then moved to the U.K., where he worked for the last 6 months of 2016.   
He earned $100,000 in first 6 months in the United States.   
He earned $100,000 in last 6 months while working in the U.K. Assume all income is taxable (no deductions allowed).

**The U.S. income tax rate is 40%. The U.K. income tax rate is 35%.**

**Assume each country has a tax system that is world-wide in scope for its citizens**.

U.S. citizens are allowed to claim a **tax deduction** for payments of foreign income tax.   
What is the total income tax Bud will pay for 2016 in both countries? (Ignore state income tax)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $70,000 | **c.** | $75,000 | **d.** | $80,000 | **e.** | $101,000 |  |

**World-wide System and Foreign Tax Credit**

Bud is citizen of United States. Bud worked in U.S. from January 1, 2016 through June 30, 2016.   
He then moved to the U.K., where he worked for the last 6 months of 2016.

He earned $100,000 in first 6 months in the United States.

He earned $100,000 in last 6 months while working in the U.K.

Assume all income is taxable (no deductions allowed).

**The U.S. income tax rate is 40%. The U.K. income tax rate is 35%.**

**Assume each country has a tax system that is world-wide in scope for its citizens**. U.S. citizens are allowed to claim a **tax credit** for payments of foreign income tax.   
What is the total income tax Bud will pay for 2016 in both countries? (Ignore state income tax)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $70,000 | **c.** | $75,000 | **d.** | $80,000 | **e.** | $101,000 |  |

**World-wide System and Foreign Tax Credit**

Jackson Corp.’s taxable income for 2016 from all of its global operations was $500,000.

Jackson Corp.’s U.S. federal income tax before credits was $200,000.   
Jackson’s taxable income from foreign sources was $100,000 during 2016.   
Jackson Corporation paid income taxes of $30,000 to foreign governments.   
Foreign income is not from a foreign subsidiary.   
What is the amount of Jackson’s total U.S. and Foreign Income tax for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $170,000 | **b.** | $200,000 | **c.** | $230,000 | **d.** | $240,000 | **e.** | Other |  |

**World-wide System and Foreign Tax Credit Limit**

Theresa (single) is a U.S. citizen. Ignore any itemized deduction or personal exemption and focus on the overall concepts. Theresa earned taxable income of $40,000, consisting of:   
(1) $20,000 of taxable income from wages in the U.S. and   
(2) $20,000 of taxable income from wages in a foreign country.   
She paid $6,000 of income taxes to the foreign country. The U.S. income tax rate is 25%.   
What is Theresa’s U.S. income tax liability after the foreign tax credit?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $1,500 | **b.** | $5,000 | **c.** | $6,000 | **d.** | $10,000 | **e.** | Other |  |

**World-wide System and Foreign Tax Credit Limit**

Jackson Corp.’s taxable income for 2016 from all of its global operations was $500,000.

Jackson Corp.’s U.S. federal income tax before credits was $200,000.   
Jackson’s taxable income from foreign sources was $100,000 during 2016.

Jackson Corporation paid income taxes of $60,000 to foreign governments.

Foreign income is not from a foreign subsidiary. What is Jackson’s foreign tax credit limit for 2016?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $200,000 | **b.** | $60,000 | **c.** | $50,000 | **d.** | $40,000 |  |  |

ABC Corp., is a domestic corporation operating abroad.

The corporation has $1,200,000 of worldwide taxable income of which $900,000 is foreign

income (taxes paid to Timbuktu are $350,000).   
The U.S. tax on worldwide income before the FTC would be $396,250.   
Compute the direct foreign tax credit for ABC Corp

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $297,188 | **b.** | $350,000 | **c.** | $154,097 | **d.** | $99,063 |  |  |

For the current year, Kelly Corp., a domestic corporation, has U.S. taxable income of $600,000, which includes $100,000 from a foreign division.

Foreign income is not from a foreign subsidiary. Kelly paid $40,000 of foreign income taxes on the income of the foreign division. Kelly's U.S. income tax for the current year before credits is $210,000.

Kelly’s maximum foreign tax credit for the current year is:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $6,400 | **b.** | $33,600 | **c.** | $35,000 | **d.** | $40,000 |  |  |

**[Sec. 904(c)]** In the item above, Kelly Corp.'s unused foreign tax credit:

|  |  |  |
| --- | --- | --- |
| **a.** | Cannot be carried to other tax years. |  |
| **b.** | Can be carried back two years and forward twenty years. |
| **c.** | Can be carried back two years and forward five years. |
| **d.** | Can be carried back three years and forward five years. |
| **e.** | Can be carried back one year and forward ten years. |

Multinational, Inc. began operations this year. It had both U.S. source and foreign source income:

|  |  |
| --- | --- |
| U.S. source income | $700,000 |
| Foreign source income | 100,000 |

Foreign income is not from a foreign subsidiary.

Multinational paid $50,000 of foreign income taxes on its foreign source income. Its U.S. tax rate is 34%. What is Multinational's U.S. tax liability if it takes the maximum foreign tax credit?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $188,000 | **b.** | $222,000 | **c.** | $238,000 | **d.** | Other | **e.** | Other |  |

**Deduction vs. Credit vs. Exclusion**

A U.S. citizen has the opportunity to earn an extra $100,000 in a foreign country.

The taxpayer’s U.S. income tax is $30,000 (marginal rate of 30%) on the foreign income.

The foreign government imposes an income tax of $20,000 on that income.   
Which will provide the most relief from double taxation on the U.S. Individual Income Tax Return?

|  |  |  |
| --- | --- | --- |
| **a.** | A deduction on the U.S. income tax return for foreign income taxes. |  |
| **b.** | A credit on the U.S. income tax return for foreign income taxes. |
| **c.** | A foreign earned income exclusion equal to total foreign earned income. |
| **d.** | All three will provide the same tax relief. |

**Foreign Earned Income Exclusion**

Sara applies for and receives a work assignment in England for Big Corp. She moved to London on 1-1-2013. She worked and lived there continuously until the April 1, 2016, when she returned to the U.S. Her salary is $200,000 per year, in all years. What is the amount of her foreign earned income exclusion for 2016? Section 911(b)(2)(D) amount for 2016 is $101,300. [closest answer.]

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $25,325 | **c.** | $40,000 | **d.** | $60,000 | **e.** | $87,600 |  |

Edgar, a U.S. citizen, was assigned to work in his company's Munich office for a 6-month period beginning April 30, 2016 and ending October 31, 2016. Edgar, who receives a salary of $200,000 per year, retained his U.S. residence and returned home each month for four days.   
What portion of Edgar's $200,000 salary may be excluded from his gross income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $61,667 | **c.** | $78,000 | **d.** | $80,000 | **e.** | Other |  |

**World-wide System. U.S. Parent Owns Foreign Subsidiary. Gross Up. Indirect credit**

White Corp is a U.S. corporation with a wholly-owned foreign subsidiary, Green Corporation.   
Green Corporation was organized on January 1, 2016.   
During 2016, Green paid $56,000 of corporate income tax to Country X.   
For 2016, Green had earnings and profits of $200,000 and paid a $200,000 dividend to White.   
White's U.S. tax rate is 34%. What is the net amount of U.S. tax (after foreign tax credit) that White Corp. must pay on the $200,000 dividend that itreceived from Green Corp.?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $12,000 | **b.** | $31,040 | c. | $56,000 | **d.** | $87,040 | **e.** | Other |  |

**Sending Income through a Subsidiary in a No Tax Country**

You are given the following information about transactions of a U.S. parent corporation (USCorp)   
and its wholly owned subsidiary corporation organized and operating in the Cayman Islands (CaySub).   
Parent (USCorp) manufactures widgets in the U.S. & sells them to its Cayman Subsidiary (CaySub).   
The Cayman Subsidiary (CaySub) sells the widgets in other parts of the world.

**Please ignore transfer pricing limits and Subpart F.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **USCorp is a domestic corporation (in U.S.).** | | | | | | | | | |
| **USCorp manufactures 100,000 widgets in U.S.** | | | | | | | | | |
| **CaySub (Cayman Sub) is organized in the Cayman Islands.** | | | | | | | | | |
| **CaySub is owned 100% by USCorp.** | | | | | | | | | |
| **U.S. income tax rate: 40%. Cayman income tax rate: 0%.** | | | | | | | | | |
| **USCorp manufacturing & freight costs:** | | | | | | | $ 500,000 | | |
| **USCorp operating expenses:** | | | | | | | 100,000 | | |
| CaySub buys all of the widgets (100,000) for (purchase price): | | | | | | | 800,000 | | |
| CaySub operating expenses: | | | | | | | 100,000 | | |
| CaySub sells all of the widgets for: | | | | | | | 1,000,000 | | |
| CaySub does not pay dividends during the tax year. | | | | | | | | | |
| **What is the total income tax for USCorp & CaySub?** | | | | | | | | |
| **a.** | $0 | **b.** | $30,000 | **c.** | $60,000 | **d.** | $80,000 | | **e.** | $130,000 | |  |

**Sending Income through a Subsidiary in a No Tax Country**

Ignore transfer pricing limits for this question. Consider Subpart F.

Repeat the preceding slide, except assume that USCorp sells the widgets to CaySub   
for **$600,000** and **CaySub sells all of the widgets outside the Cayman Islands.**

What is the total income tax for USCorp and CaySub?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $30,000 | **c.** | $40,000 | **d.** | $800,000 | **e.** | $120,000 |  |

**If the product is either produced in the Cayman Islands, or sold in those islands, it is not subpart F income. If the product is both produced outside the Cayman Islands and sold outside the Cayman Islands (and the Cayman corporation is just a convenient tool for sticking income in a tax haven) then subpart F does apply. That is the case here. Parent corporation has constructive dividend.**

**Sending Income through a Subsidiary in a No Tax Country, with ultimate sale in the no tax country**

Repeat preceding question except assume that CaySub sells all of the widgets in the Cayman Islands.   
USCorp sells the widgets to CaySub for $600,000.  
CaySub **sells all of the widgets in the Cayman Islands** for $1,000,000.   
CaySub has profit of $300,000. Subpart F is NOT applicable to income earned by CaySub.   
What is the total income tax for USCorp and CaySub?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $30,000 | **c.** | $40,000 | **d.** | $800,000 | **e.** | $120,000 |  |

However, the IRS will be very unhappy with the transfer pricing and will be glad to compute the income of the parent based on a different set of intercompany prices. The IRS will increase the profit recognized on the sale by the parent, to generate a reasonable profit in the U.S.