

# FDU: U.S. International Corporate Tax

- 124  **Definition: FPHC Income**
- **Foreign Personal Holding Company Income: Subpart F concept: §954(c)**
  - **Generally interest, dividends, rents, royalties, gain from passive asset sale, foreign currency gain**
  - **Excludes same country related party interest & dividends**
  - **Excludes related party rents & royalties from prop. used in same country**
  - **Excludes active business rents & royalties**
- 125  **Look Thru Rules**
- §904(d)(3), Reg. §1.904-5
  - **Passive income from CFC in which taxpayer is US shareholder treated as general limitation, except as provided**
    - CFC
    - US Shareholder
  - **Applies to Subpart F inclusions also**
- 126  **Look Thru--Dividends**
- **Basketize CFC E&P and taxes (see later)**
  - **De minimis (5% or \$1 million) amounts (within CFC) not separate basket**
  - **Attribute dividend proportionately to E&P baskets**
  - **Anti-abuse rule for dividend of interest income from related party loans**
- 127  **Denial of Look Thru**
- **Pre-acquisition earnings of CFC considered separate 902 basket on distribution: no look thru**
    - Provisions effective after 2006 are confusing, but result in a deemed separate basket
  - **Complex anti-abuse rule**
  - **Earnings of CFC retain character if CFC dropped into holding co.**
- 128  **Look Thru--Subpart F**
- **Treat as separate basket to extent in CFC's separate basket**
  - **Rules that kick income out of passive basket apply before this rule**
  - **Exclusions under Subpart F 90% high tax kickout considered general basket**
  - **Subpart F full inclusion rule has no effect on baskets**
- 129  **Look Thru—Misc.**
- **Applies to 50% or more owned nonconsolidated domestic corp.**
  - **Look thru partnership**
    - Except under 10% corporate GP or any limited partner owning under 10%:
    - Their income is passive
  - **Gain on sale of partnership interest is passive or high tax kickout**
  - **Tiered look thru**
  - **Ordering rules**
- 130  **Look Thru Exercise**
- 131  **Allocating Taxes (non-902)**

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– Reg. §1.904-6(a)

- **Allocate foreign tax to all income subject to that tax**
- **Use foreign rules for determining whether income is taxed**
- **If tax is on multiple baskets, apportion:**  
Net income (foreign concept) in basket  
Tax x  $\frac{\text{Net income (foreign concept) in basket}}{\text{Net income (foreign concept) subject to tax}}$
- **Use foreign tax principles for determining net income, or 861 rules if no foreign rules**

## 132 Associating Deductions with Income

## 133 Allocation of Expenses

– §§861(b), 862(b), 863(a), 864(e), (f); Reg. §1.861-8 thru 14

- **Foreign tax credit limitation based on net foreign source taxable income**
- **Must allocate & apportion deductions related to income**
- **Specific rules for interest, R&D, stewardship**

## 134 Expense Allocation: Code Rules

- **Reduce specific FSI for:**
  - Deductions properly allocated or apportioned plus
  - Ratable part of deductions not definitely allocated to item or class of gross income
- **Interest, R&D, stewardship, plus exp. not directly related to some income producing activity allocated & apportioned on consolidated basis**
- **Secretary to prescribe regulations**

## 135 Key Concepts

- **Gross income**
  - Sales less cost of sales
  - Other income
- **Deductions**
  - Includes losses
- **Item of gross income**
- **Class of gross income**
  - Determined by reference to deductions
  - Different deductions may give rise to different classes

## 136 Allocation vs. Apportionment

- **Allocate deductions related to class of gross income**
- **Apportion deductions related to all classes or not related to any class**
- **May require allocation then apportionment**
- **Factual relationships**
- **Expanded cost accounting**

## 137 Allocating Techniques

- **Multi-tier cost allocations**
  - Support functions: Reg. §1.861-8T(b)(3)
  - See regs. under §263A
- **Basis for allocating: fact based**

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- Must allocate expense to class even if no income in class for year

## 138 **Determining Factual Relationships**

- Ask questions of operations people
- Profit/cost center reports
- Questionnaires & checklists
- Activity Based Costing

## 139 **Special Rules**

- Interest
  - Consolidated, asset based
- Research & experimentation
  - Consolidated, based on sales or gross income
- Stewardship
- Income taxes
- Contributions: apportion among all GI
- Losses other than stock & inventory: same as gain on such property (with exceptions; not covered)

## 140 **Income Taxes**

– Reg. §1.861-8(e)(6)

- Regs may be contrary to Mobil
- Allocate taxes, incl. state, among income in tax base
- Not consolidated unless combined state return

## 141 **State Income Taxes**

- Permanent election of one of two optional methods:
  - Both require reducing federal base for income in states with no tax
  - 110% method
  - 100% method

## 142 **Stewardship**

- Stewardship = managing investment in subs
  - Examples: review of sub's borrowing needs, review of sub's performance
- Identify costs, including:
  - Officer's compensation & expenses
  - Support functions
- Directly allocate, or allocate then apportion

## 143 **Stewardship vs. Billable**

- PLR 8806002, Young & Rubicam
- Costs that directly benefit subs should be billed to subs
- Failure to bill will result in reduced FSTI or 482 adjustment
- If documented right, can get deduction overseas
- 482 adjustments may impact allocation of expenses in this regard

## 144 **R&D**

– Reg. §1.861-17

- Consolidated return basis

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- **Basic concept:** allocate part to where performed, apportion balance
- **Apportioned on 3 digit SIC code groups (with grouping)**
- **R&D expenses defined the same as for §174**

## 145 **R&D, Summary**

- **Identify 3 digit SIC group (elective grouping)**
- **Summarize costs by such group**
- **Allocate for regulatory requirements**
- **Allocate & Apportion balance**
  - Sales method: 50% to situs, 50% apportioned
  - Gross income method: 25% to situs, 75% apportioned
- **Use worldwide sales for products benefited**

## 146 **R&D, cont.**

- **Sales of controlled & uncontrolled similar to prior regs.**
- **Gross income method apportionment to statutory must be at least 50% of sales method**
- **Binding election of method for 5 year blocks**