

International Tax Structures

for Americans Living Abroad

Foreign Tax Credit Structure #3

Mexican Foreign Tax Credit Royalty Withholding

A U.S. citizen and resident claims a Foreign Tax Credit for Royalty Withholding taxes paid to Mexico in lieu of foreign income taxes. This structure occurs when intellectual property is used in a foreign country (resulting in foreign source income) and foreign tax credits are available to eliminate double taxation.

Summary of the Foreign Tax Credit (§901)

The Foreign Tax Credit (FTC) is a U.S. tax benefit that helps prevent double taxation by allowing taxpayers to offset U.S. tax liability with income taxes paid to a foreign country. It's available to U.S. citizens, resident aliens, and some corporations that have foreign-source income. Instead of excluding the income like the FEIE, the FTC lets you claim a dollar-for-dollar credit for eligible foreign taxes, up to the amount of U.S. tax owed on that income.



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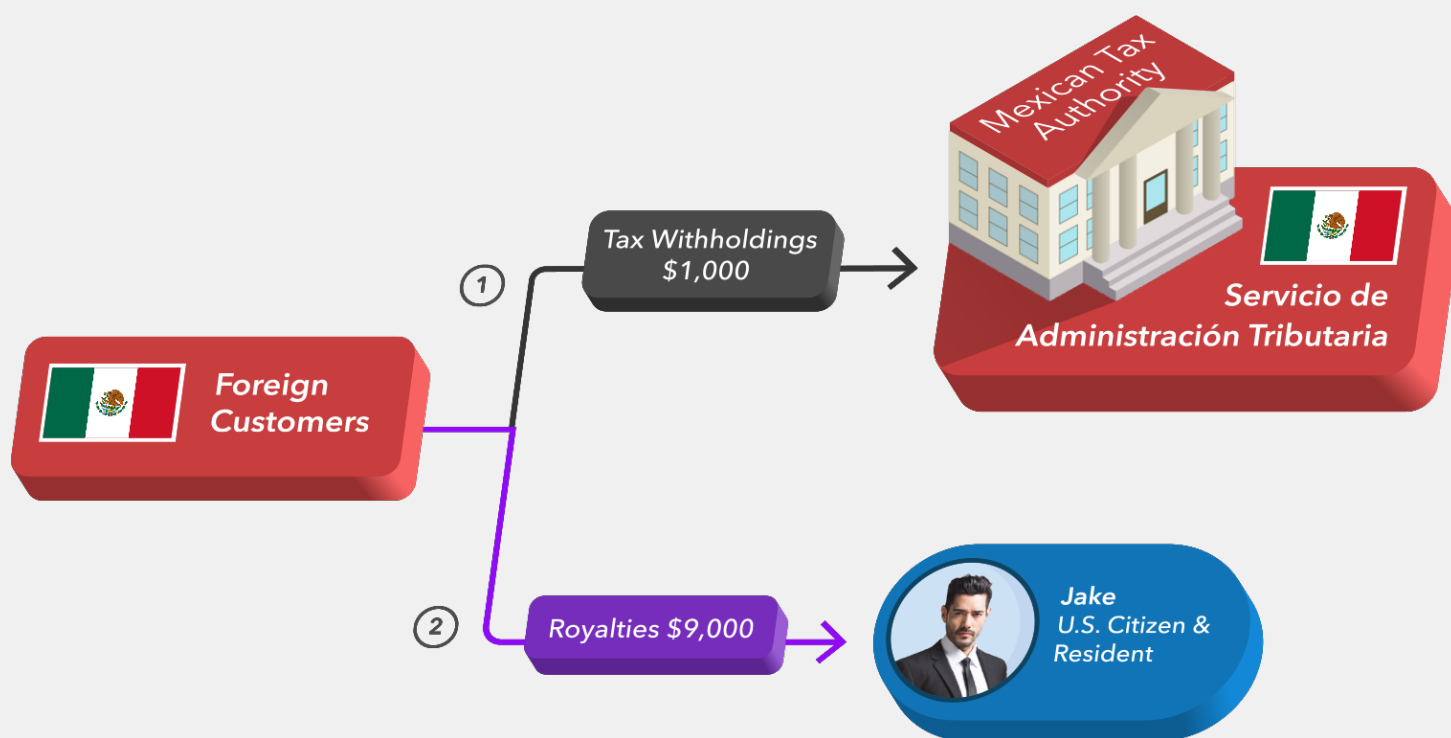
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Structure Background

Jake, a United States citizen and resident, sells digital content and software subscriptions in Mexico, generating royalty income. Jake also has a salary-earning job in the United States, which serves as his primary source of income.

All of Jake's royalty sales are from Mexican Customers. According to the tax treaty rate for royalty payments, a 10% withholding tax is payable to the Mexican Tax Authority.

Generally, a Foreign Tax Credit is claimed on the U.S. person's income tax return only if an income tax is paid. However, credible foreign taxes also include taxes assessed in lieu of an income tax, as per Internal Revenue Code §903.



Mexican Foreign Tax Credit Royalty Withholding

Monetary Transactions

- 1. During the year, Jake earns \$10,000 of Royalties from Mexican customers for content and digital subscriptions. Based on tax treaty rates, 10% is withheld and paid directly to the Mexican Tax Authority, Servicio de Administración Tributaria.
- 2. The remaining \$9,000 of royalty income is paid to Jake for his foreign-sourced compensation of the digital content and subscription.

Tax Compliance

- 3. **Form 1040 (Jake).** Based on its foreign source royalty income, he claims a Foreign Tax Credit of \$1,000 on [Form 1116, Foreign Tax Credit \(Individual, Estate, or Trust\)](#).

Summarized Tax Returns and Financial Statements

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Form 1040	Jake (Single)
U.S. Salary	\$160,000
Royalties (Mexico)	\$10,000
Standard Deduction	- \$12,000
Taxable Income	\$158,000
U.S. Tax	\$39,500
Foreign Tax Credit	- \$1,000
Withholding (Salary)	- \$40,000
Total U.S. Tax or (Refund)	(\$1,500)

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Resulting Tax Implications

As a result of this structure, the creditable foreign taxes available to Jake are \$1,000, which he can claim in full, and his total U.S. income tax liability is \$39,500, including taxes on his U.S. salary. Based on withholding, he will then receive a refund of \$1,500.

Effective Tax Rate (Foreign Royalties)

Gross Income from All Sources	\$10,000
Gross Expenses from All Sources	\$1,000
Total Net Income	\$9,000
Federal Income Tax	\$0
Effective Tax Rate (Single)	0%

* For the purposes of this U.S. Federal Income Effective Tax Rate calculation, the Foreign Tax Credit is treated as an expense.

About the Author



Marcus Marcial is a seasoned tax professional with experience predominantly dealing with International Taxation. Originally from Southern California, he attended Hunter College in New York City and has resided abroad for many years.

While employed at the IRS, he learned from examining and preparing tax returns for individuals residing and businesses operating offshore. After leaving the IRS, he started his own tax firm, helping various international clients with tax compliance, accounting, and consultation.



To schedule a consultation to discuss the structures and tax law references found in this document or for a custom structure, tax filing, planning, and strategy, visit <https://pacifico.tax/schedule-consultation>

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