

International Tax Structures

for Americans Living Abroad

Foreign Tax Credit Structure #5

Foreign Tax Credit for Costa Rican Rental Property (U.S. Higher Rate)

A U.S. Individual claims a Foreign Tax Credit for Real Estate Property rented in Costa Rica, with a Value Added Tax (IVA), and a Foreign Income Tax applies. As his U.S. tax rate is higher than the foreign tax imposed in Costa Rica, the difference in tax is paid to the United States.

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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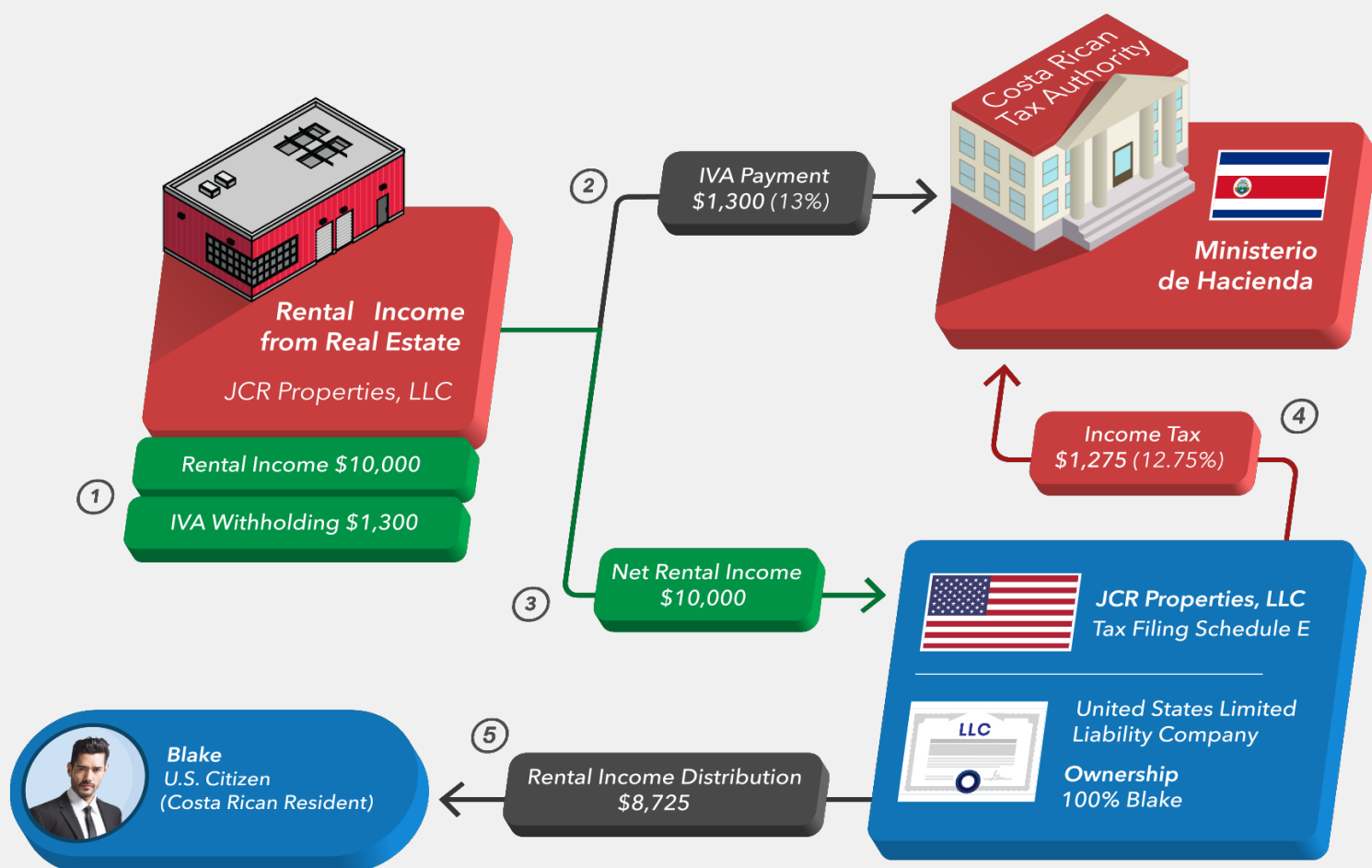
Structure Background

Blake, a U.S. Citizen and Costa Rica resident, is the sole owner of JCR Properties, LLC, a Single Member LLC that owns properties for rent in Costa Rica. The income, expenses, and related credits are reported on his individual tax return (Schedule E), as JCR Properties, LLC is a Disregarded Entity for Federal tax purposes per Treasury Regulation § 301.7701-3.

There are two taxes imposed on rental income:

- El Impuesto sobre el Valor Agregado (IVA), a Value Added Tax of 13%, is charged based on the sales income from rental properties.
- An Income Tax of 12.75% based on Gross Receipts of income from business activities generated in the country.

Blake claims a Foreign Tax Credit for taxes that are an Income Tax, per Internal Revenue Code §901.



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Monetary Transactions

1. During the year, the rental property generates \$10,000 of rental income, of which \$1,300 is withheld from customers for IVA, totaling \$13,000 of gross income.
2. The IVA payment is made to the Ministerio de Hacienda, in the amount of \$1,300.
3. Net Rental Income of \$10,000 is deposited into the bank account held by JCR Properties, LLC.
4. An Income Tax payment is made to the Ministerio de Hacienda, in the amount of \$1,275.
5. A rental income distribution is made to Blake of \$8,725 for the remaining profits.

Tax Compliance

6. **Form 1040 (Blake).** Based on its foreign source rental income, Blake reports \$11,300 of gross income, \$1,300 as an IVA Expense from the rental property, and a Foreign Tax Credit of \$1,275. As his effective tax rate in the U.S. is 20% (a \$2,000 liability), the difference in the higher tax is \$725 owed to the United States.

Summarized Tax Returns and Financial Statements

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Form 1040	Blake
U.S. Individual Income Tax Return	
Foreign Rental Income	\$11,300
IVA Expense	- \$1,300
Taxable Income	\$10,000
U.S. Individual Tax	\$2,000
Foreign Tax Credit	- \$1,275
Total U.S. Individual Tax	\$725

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Resulting Tax Implications

As a result of this structure, the creditable foreign taxes are \$1,275, and Blake’s U.S. income tax liability is \$725.

Effective Tax Rate (Foreign Rents)

Gross Income from All Sources	\$11,300
Gross Expenses from All Sources	\$2,575
Total Net Income	\$8,725
Federal Income Tax	\$725
Effective Tax Rate (Single)	8.3%

* 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>

DISCLAIMER

The International Tax Structures included in this publication are hypothetical structures and set of circumstances and tax rates that do not apply to any particular taxpayer and for any purpose. The information included in this tax structure is non-transferable or reusable, as each taxpayer's situation is factually unique.

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