

International Tax Structures

for Americans Living Abroad

Net CFC Tested Income Structure #2

NCTI Inclusion for U.S. Individual (Product Sales of Hong Kong CFC)

An Individual owner of a Foreign Corporation is subject to Net CFC Tested Income (NCTI) for the sales of physical goods shipped to the United States.

Summary of the Net CFC Tested Income (§951A)

Net-CFC-Tested Income (NCTI) is a category of income to target profits earned by Controlled Foreign Corporations (CFCs) that are subject to low foreign taxes. U.S. shareholders of CFCs must include a portion of the CFC's income in their current U.S. taxable income, even if it isn't distributed. Corporations (or individuals who claim a valid section 962 election) can claim a 40% deduction and up to 90% foreign tax credits used to reduce the impact.

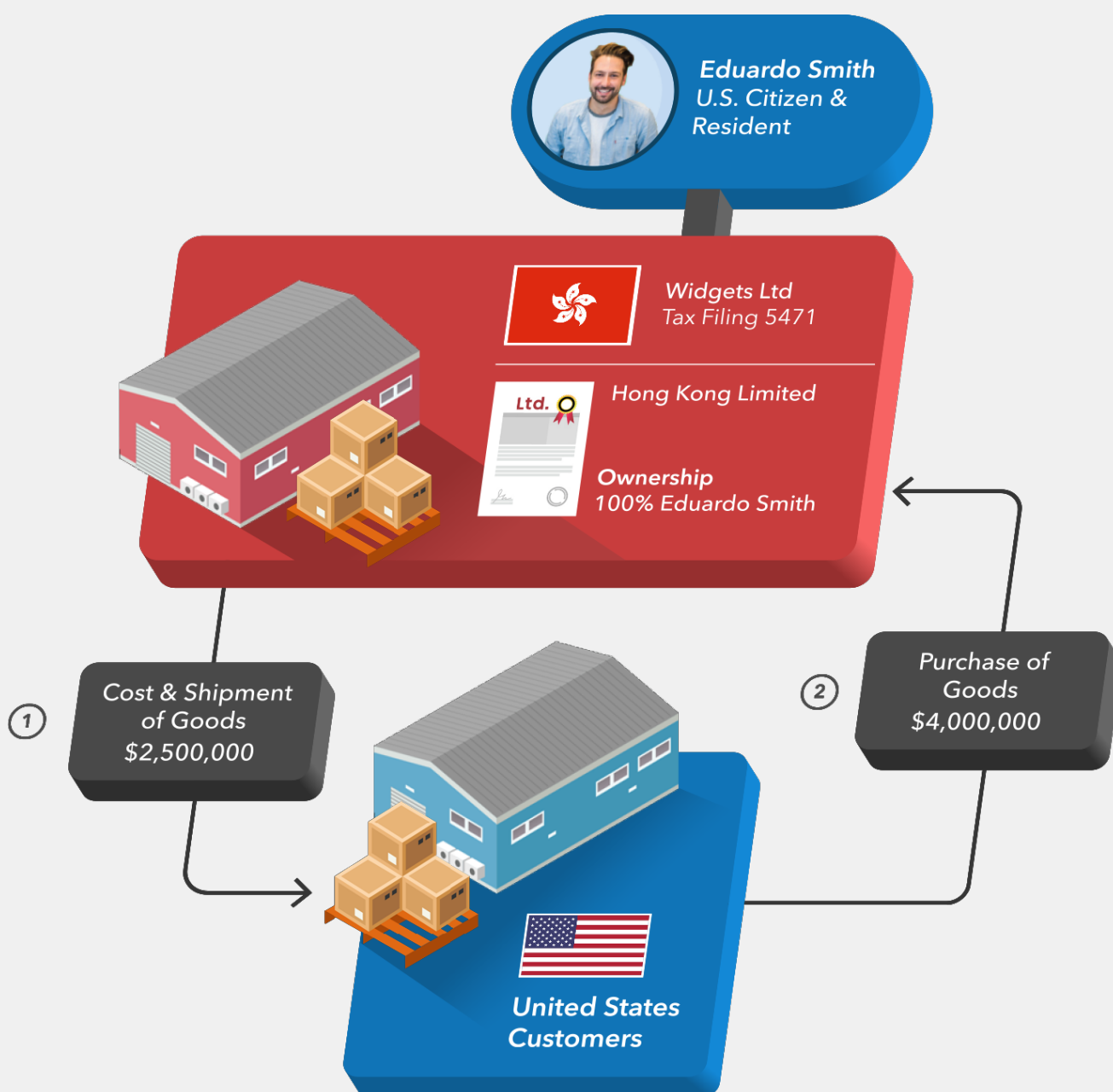


Prepared By
PACIFICOTAX

The International Tax Structures included in this publication are hypothetical structures. Read the attached Disclaimer and read our [Terms](#) to learn more.

Structure Background

Widgets Ltd., a Hong Kong Limited company, is a seller of widgets that are produced in Hong Kong and shipped to U.S. customers. After the widgets are produced in Hong Kong, they are shipped directly to customers located in the United States in bulk. The sole owner of Widgets Ltd. is Eduardo Smith, a United States citizen and resident. As Eduardo is the sole owner, Widgets Ltd. is a Controlled Foreign Corporation per Internal Revenue Code §957. During the year, Widgets Ltd. earned Net Income from the sale of widgets in which no foreign taxes were paid, and no dividend distributions were paid to Eduardo.



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Exempt from Subpart F

As the widgets are manufactured in the country of incorporation (Hong Kong), there is no inclusion of Subpart F Foreign Base Company Sales Income (FBCSI) per Internal Revenue Code §954(d).

No U.S. Sourcing & No Branch Profits Tax

As the widgets are shipped directly from Hong Kong to the United States, they have a foreign origin shipping point and a U.S. destination customer. Based on sourcing rules, there is no U.S. source income. Additionally, Widgets Ltd. does not conduct a trade or business in the United States within the meaning of Internal Revenue Code §862, having no Permanent Establishment. As a result, no Branch Profits tax applies.

Subject to NCTI

However, the gross income from the sale of widgets described in this structure is subject to Net CFC Tested Income (NCTI) per Internal Revenue Code §951A. Specifically, the gross income of the corporation is subject to NCTI “Tested Income” subject per Internal Revenue Code §951A(c)(2).

Monetary Transactions & Accounting

1. Widgets Ltd. manufactured goods during the year costing \$2,500,000
2. The goods were later sold for \$4,000,000 and shipped directly from the manufacturing warehouse in Hong Kong to the customer's warehouse in the U.S.
3. At the close of the year, the Net Income from the business was \$1,500,000 (\$4,000,000 of Revenue less \$2,500,000 of Cost of Goods Sold). On the Balance Sheet, the business had the following assets: \$200,000 in cash, \$1,200,000 in equipment, and \$3,000,000 in inventory ready for sale.

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U.S. Tax Filing Compliance

4. **Form 5471 (Widgets Ltd.)** The foreign corporation must be disclosed on [Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations](#), to satisfy the reporting requirements of Internal Revenue Code §6038. This form must be attached to Eduardo's personal tax filing.
5. **Form 8992 (Widgets Ltd.).** The gross income from the foreign corporation must be reported on [Form 8992, U.S. Shareholder Calculation of Net CFC Tested Income \(NCTI\)](#), attached to Form 5471, to calculate the includable income. For this year, NCTI is equal to \$1,500,000.
6. **Form 1040 (Eduardo Smith).** On his personal Federal income tax return, Eduardo includes his NCTI inclusion of \$1,500,000, resulting in U.S. tax of \$546,096 (even if no dividends were paid during the year).

Summarized Tax Returns and Financial Statements

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Widgets Ltd. Income Statement		Widgets Ltd. Balance Sheet	
Sales Revenue	\$4,000,000	Cash	Liabilities
		\$200,000	\$3,000,000
Cost of Goods Sold	- \$2,500,000	Equipment	Equity
		\$1,200,000	\$1,400,000
Net Income	\$1,500,000	Inventory	
		\$3,000,000	

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Form 5471	Widgets Ltd.
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Form 8992 Net CFC Tested Income	
Tested Income	\$1,500,000
NCTI = \$1,500,000	

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Form 1040	Eduardo Smith (Single)
NCTI Inclusion	\$1,500,000
Total Income	\$1,500,000
Standard Deduction	- \$12,000
Taxable Income	\$1,488,000
U.S. Tax	\$546,096

Resulting Tax Implications

As a result of this structure, Eduardo must recognize a Net CFC Tested Income Inclusion of \$ 1,500,000 to his taxable income, and the income tax owed personally is \$546,096, with an effective tax rate of 36.7%. This occurs even if Eduardo received no repatriated distributions from the foreign corporation.

Effective Tax Rate

Gross Income from All Sources	\$4,000,000
Gross Expenses from All Sources	\$2,500,000
Total Net Income	\$1,500,000
Federal Income Tax	\$546,096
Effective Tax Rate (Corporate)	36.4%