

International Tax Structures

for Americans Living Abroad

Net CFC Tested Income Structure #3

NCTI Inclusion for U.S. Individual (With 962 Election)

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. He elects to claim a 962 Election, treating NCTI as if he were a U.S. corporation, thereby reducing his taxable inclusion.

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.

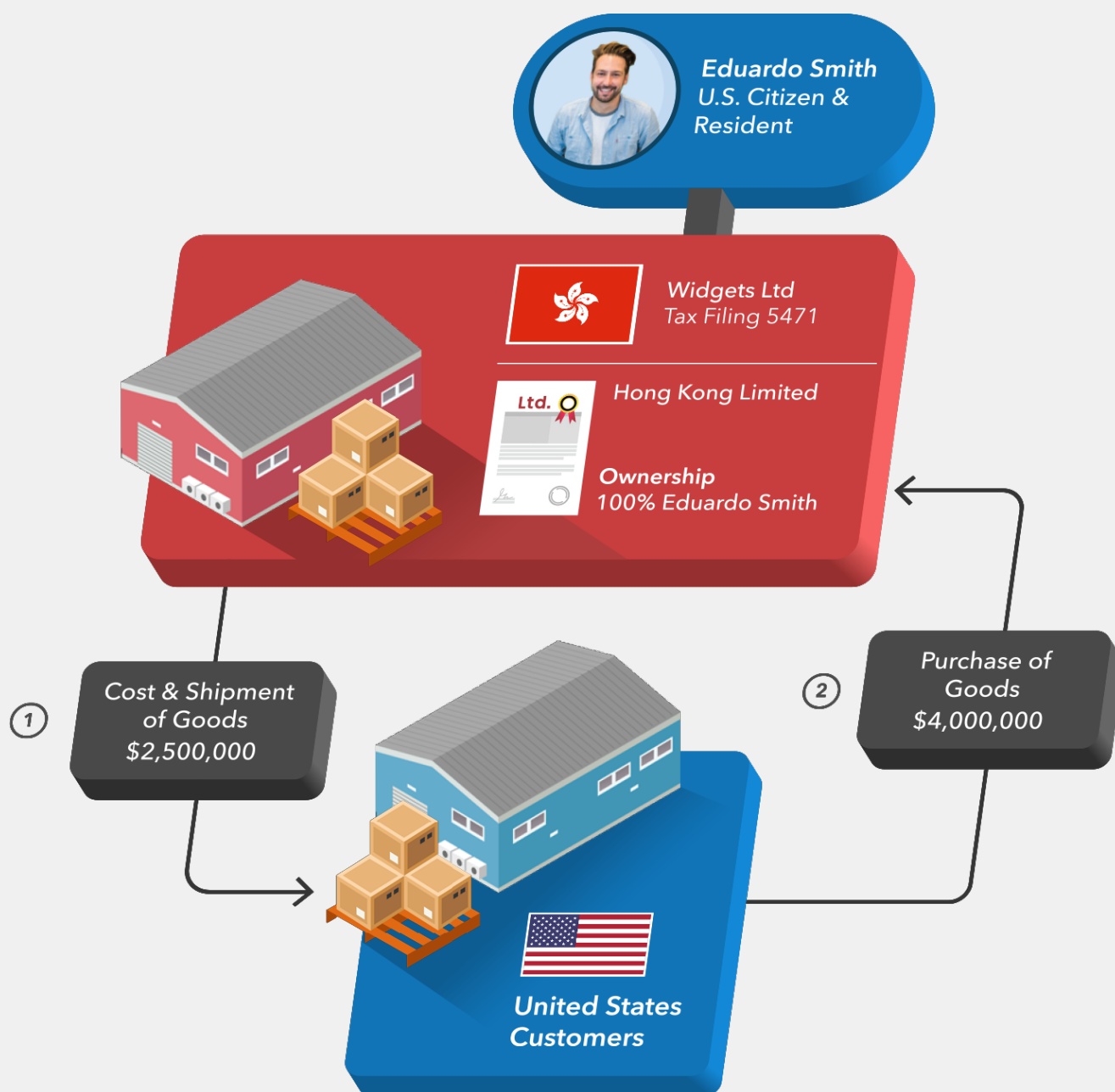


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Structure Background

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.



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

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).

Section 962 Election

Eduaro elects to treat Widgets Ltd. to be taxed as if it were a C-Corporation per Internal Revenue Code §962. The resulting effect is that its Net Income is subject to a 21% Corporate Tax Rate, but also qualifies for a 40% reduction in NCTI through Internal Revenue Code §250.

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.

Section 250 Deduction & Taxable Income Calculation

There is a reduction of 40% of NCTI income (referred to as a Section 250 Deduction) as a result of the 962 Election. Additionally, the Foreign Corporation's income after this deduction is taxed at 21%, and also considers up to 90% of any foreign taxes paid. However, for this year, Widgets Ltd. paid no foreign taxes.

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 of Tested Income.
6. **Form 8993 (Widgets Ltd.)**. The Section 250 Deduction is reported on [Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income \(FDII\) and Net CFC Tested Income \(NCTI\)](#), also attached to Form 5471.
7. **Form 1040 (Eduardo Smith)**. On his personal Federal income tax return, Eduardo includes his NCTI inclusion of \$900,000, resulting in personal income tax of \$189,000 [$\$1,500,000 - \$600,000$ (40% of Inclusion) $\times$ 21% Corporate Tax Rate], 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	\$900,000
U.S. Tax	\$189,000
	[21 % Corporate Tax]

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Form 8993 Section 250 Deduction

NCTI	\$1,500,000
Section 250 Deduction [40% of NCTI]	- \$600,000
Taxable Inclusion = \$900,000	

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. After deductions available as part of the 962 Election, the income tax owed personally is \$189,000, with an effective tax rate of 12.6%. 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	\$189,000
Effective Tax Rate (Corporate)	12.6%