

# International Tax Structures

## *for Americans Living Abroad*

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### Net CFC Tested Income Structure #4

## NCTI High-Tax Exemption and C-Corporation DRD from El Salvador

A United States C-Corporation with a foreign subsidiary as a Controlled Foreign Corporation claims a high-tax exemption to Net CFC Tested Income (NCTI), and a Dividends Received Deduction from expatriated dividends. Additionally, salaries are paid from the Foreign Subsidiary to the indirect shareholders.

### 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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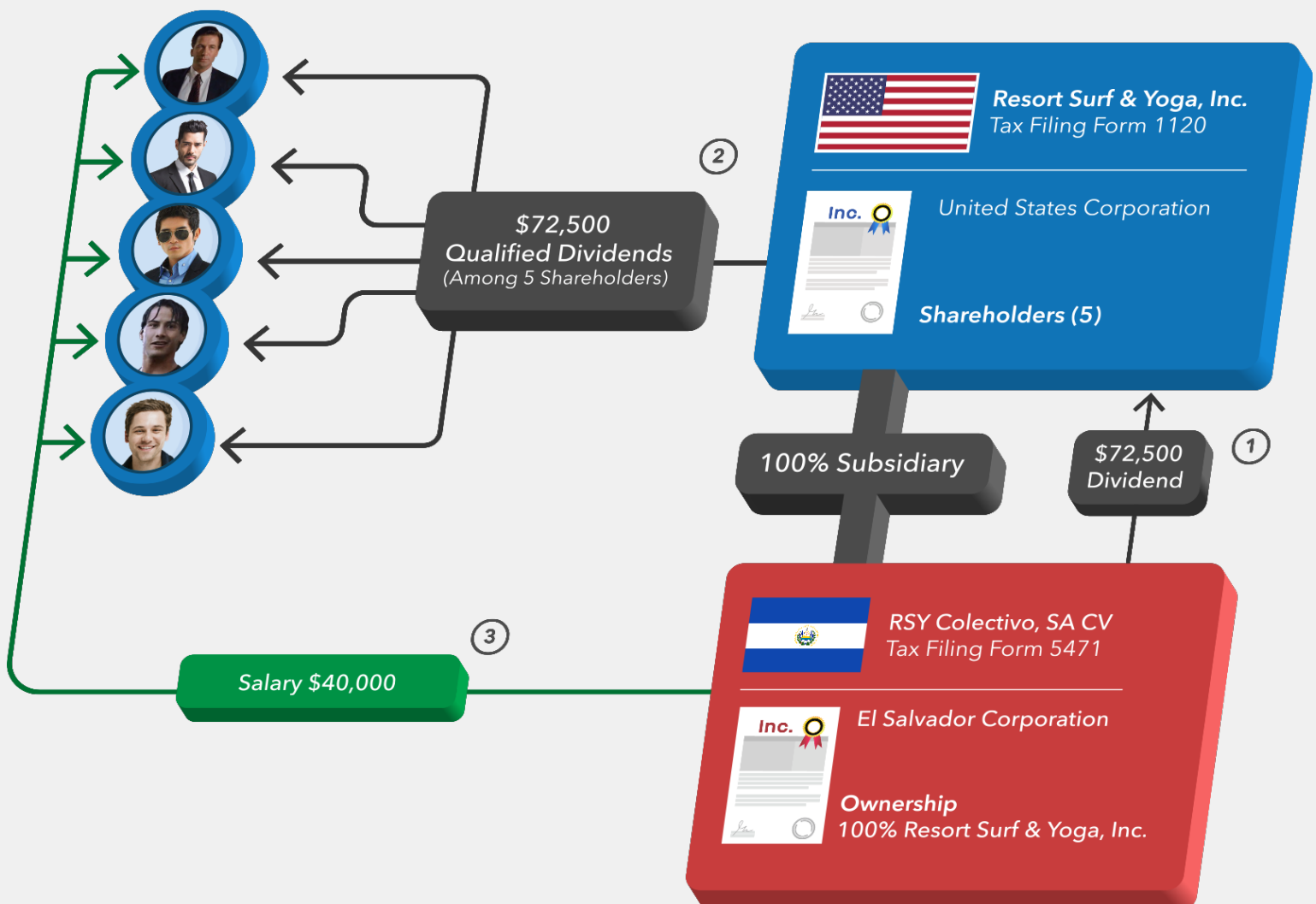
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## Structure Background

Resort Surf & Yoga, Inc., a United States C-Corporation, and a provider of travel and leisure services. To operate overseas, an El Salvadorian corporation was formed as a wholly owned subsidiary and owned assets offshore. The foreign corporation, RSY Colectivo, SA CV is a Controlled Foreign Corporation per Internal Revenue Code §957 and hires local staff working physically in El Salvador for administration and management. There is no inclusion of Subpart F (Foreign Base Company Sales Income) per Internal Revenue Code §951 and §952, as the employees are working in the country of formation.

The net earnings for RSY Colectivo, SA CV are not subject to Net CFC Tested Income (NCTI) per Internal Revenue Code §951A due to a high tax exemption based on the tax rate in El Salvador. The Net Income from RSY Colectivo, SA CV was \$150,000, of which \$37,500 was paid at a 25% tax rate.

Dividends from the foreign subsidiary to the parent U.S. company qualify for a Dividend Received Deduction per Internal Revenue Code §243.



## Monetary Transactions & Accounting

1. Dividends paid from the Foreign Corporation to the U.S. parent company total \$72,500. The U.S. corporation claims a Dividend Received Deduction.
2. Qualified Dividends paid from the U.S. Corporation to the shareholders total \$72,500. Each shareholder reports these dividends on their personal tax return, subject to qualified rates.
3. Salaries are paid to indirect shareholders who provide personal services to the Foreign Corporation as employees.
4. The Net Income for RSY Colectivo, SA CV is \$72,000, all of which has been distributed.

## U.S. Tax Filing Compliance

5. **Form 1120, with Form 5471 (Resort Surf & Yoga, Inc.).** On its U.S. corporate tax return, Resort Surf & Yoga, Inc. reports the Dividends from its subsidiary, but claims a Dividends Received Deduction to reduce its taxable income to \$0. Additionally, the U.S. Corporation must file [Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations](#), in relation to its ownership of the foreign corporation to satisfy the reporting requirements of Internal Revenue Code §6038. There is no Net CFC Tested Income as a result of a High Tax Exemption.

## Summarized Tax Returns and Financial Statements

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### RSY Colectivo, SA CV Income Statement

|                       |            |
|-----------------------|------------|
| Income                | \$150,000  |
| Salary Expenses       | - \$40,000 |
| Tax Expense           | - \$37,500 |
| <hr/>                 |            |
| Net Income            | \$72,000   |
| Dividend Distribution | \$72,000   |
| Retained Earnings     | \$0        |

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### Form 1120 Resort Surf & Yoga, Inc.

|                             |            |
|-----------------------------|------------|
| Dividend Income             | \$72,000   |
| Dividend Received Deduction | - \$72,000 |
| NCTI                        | + \$0      |
| <hr/>                       |            |
| Taxable Income              | \$0        |
| Corporate Tax (21%)         | \$0        |

### Form 5471 RSY Colectivo, SA CV

|                    |            |
|--------------------|------------|
| Tested Income      | \$150,000  |
| High-Tax Exemption | \$-150,000 |
| <hr/>              |            |
| Taxable NCTI       | \$0        |

## Resulting Tax Implications

As a result of this structure, the corporate tax liability of Resort Surf & Yoga, Inc. is \$0.

The Personal Income Tax rate for Qualified Dividends, being 15% among all shareholders, results in a projected \$10,875 of personal income tax among all shareholders combined.



**Personal Tax Liability.** Note, the personal income tax liability for each shareholder may vary depending on their particular circumstance.

Effective Tax Rate

|                                           |                  |
|-------------------------------------------|------------------|
| <b>Gross Income</b><br>from All Sources   | <b>\$150,000</b> |
| <b>Gross Expenses</b><br>from All Sources | <b>\$77,500</b>  |
| <b>Total Net Income</b>                   | <b>\$72,000</b>  |
| <b>Federal Income Tax</b>                 | <b>\$0</b>       |
| <b>Effective Tax Rate</b><br>(Corporate)  | <b>0%</b>        |

\* The above Effective Tax Rate applies at the Corporate level, and effective rates for individual shareholders will vary.