

The Form 5471 Series

Episode 8. Foreign Tax Credit

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Philip D. W. Hodgen
HodgenLaw PC | Pasadena, CA
hodgen.com

The Form 5471 Series: 2023 - 2024

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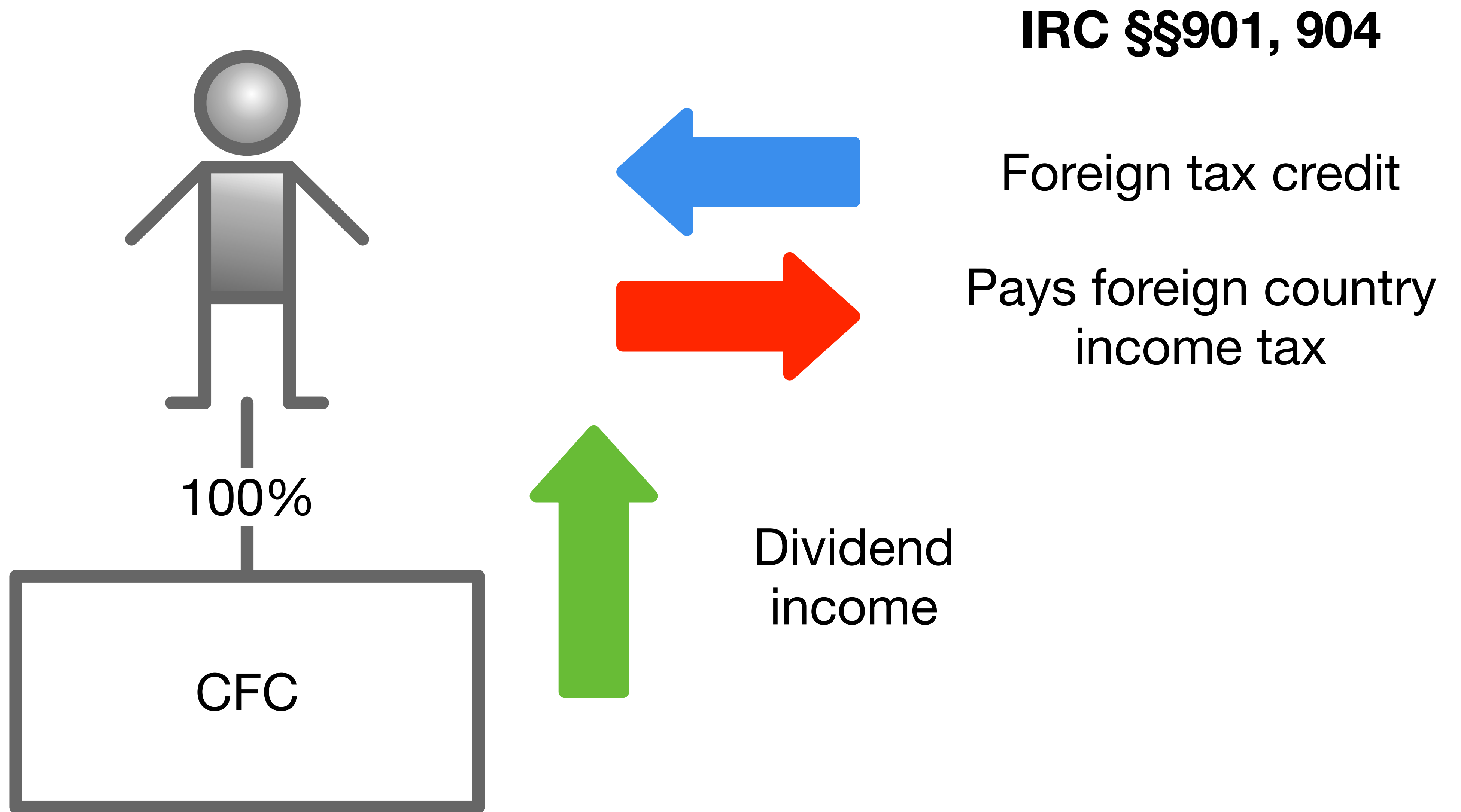
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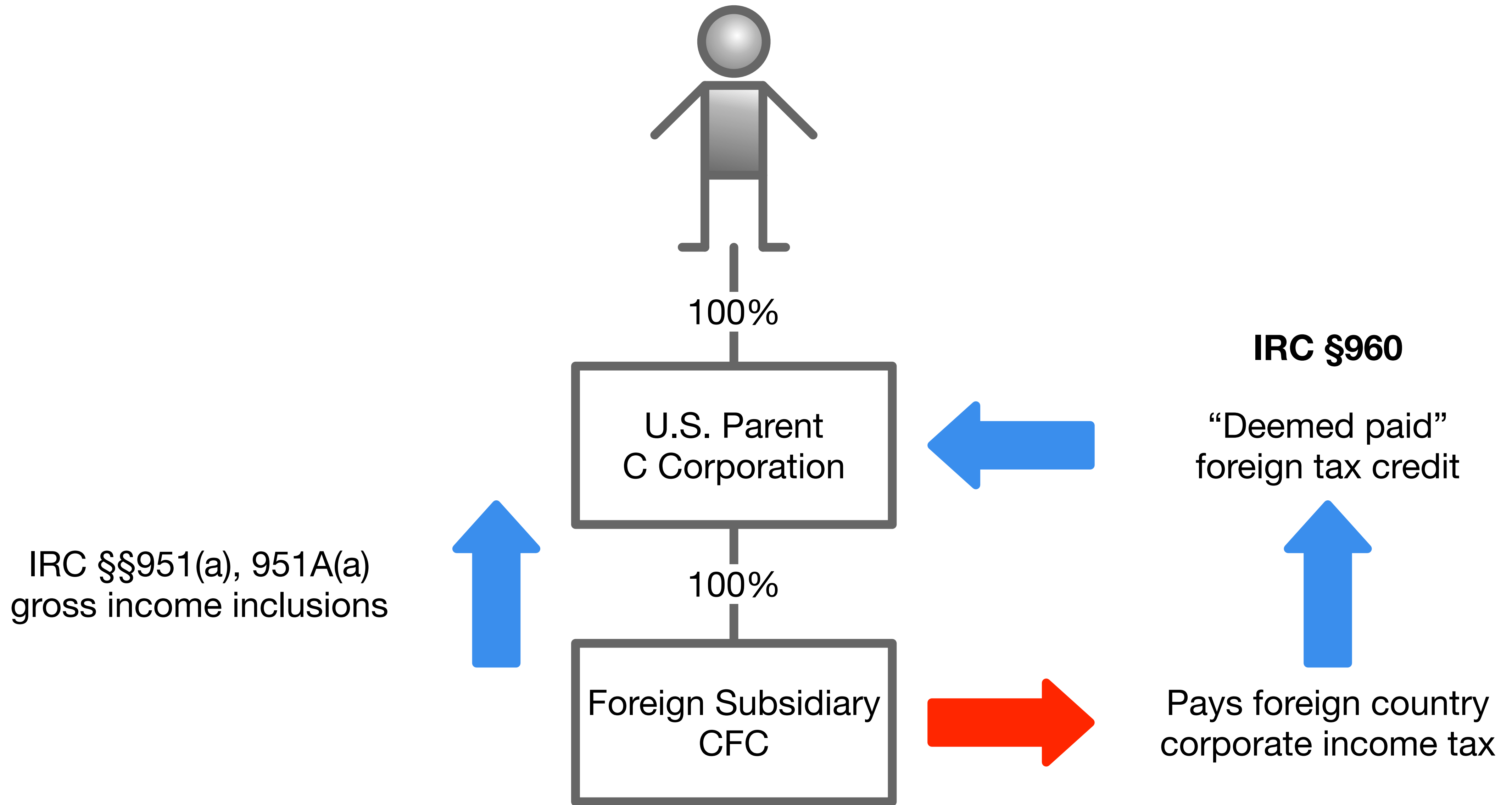
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1. Introduction

Two types of foreign tax credit

- **Direct** - “You actually paid the foreign income tax, so you can claim a foreign tax credit.”
- **Deemed paid** - “A controlled foreign corporation paid foreign income tax, but a United States shareholder that is a domestic corporation (or an individual who makes the Section 962 election) can claim a foreign tax credit.”





2. The Foreign Tax Credit Rules

IRC §§27, 901, 904, 960

IRC §27: enables the foreign tax credit

IRC §27: the authorization for foreign tax credit

“The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by this chapter to the extent provided in section 901.”

IRC §27.

IRC §901: the implementation details

IRC §27: all the important stuff happens in IRC §901

“The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by this chapter **to the extent provided in section 901.**”

IRC §27.

IRC §901(a): credit allowed for “paid” and “deemed paid” taxes

“If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of **subsection (b)** plus, in the case of a corporation, the **taxes deemed to have been paid under section 960**. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b).”

IRC §901(a).

IRC §901(b)(1): tax paid is your credit, unless IRC §904 overrides

“[Unless IRC §904 limits the amount of allowable credit], [i]n the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States[.]”

IRC §901(b)(1).

IRC §904: limits on the amount of foreign tax credit allowable

IRC §901(a): credit amount is limited by IRC §904

“If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, **subject to the limitation of section 904**, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b).”

IRC §901(a).

Foreign tax credit limited to U.S. tax liability on the income

“The total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.”

IRC §904(a).

IRC §960: a domestic corporation's tax credit for CFC-paid taxes

IRC §901(a): cross-reference to taxes deemed paid under IRC §960

“If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b).”

IRC §901(a).

U.S. shareholder deemed to pay CFC-paid tax on subpart F income

“For purposes of subpart A of this part, if there is included in the gross income of a domestic corporation any item of income under **section 951(a)(1)** with respect to any controlled foreign corporation with respect to which such domestic corporation is a United States shareholder, such domestic corporation **shall be deemed to have paid** so much of such foreign corporation's foreign income taxes as are properly attributable to such item of income.”

IRC §960(a).

U.S. shareholder deemed to pay 80% of CFC tax on IRC §951A income

“For purposes of subpart A of this part, if any amount is includible in the gross income of a domestic corporation under **section 951A**, such domestic corporation shall be deemed to have paid foreign income taxes equal to **80 percent** of the product of [*math problem*].”

IRC §960(d)(1).

“This subpart A” and “this chapter”

“For purposes of subpart A” means IRC §§901 - 909

- Internal Revenue Code (*Title 26 of the United States Code*)
- Subtitle A — Income Taxes (Sections 1 to 1564)
- Chapter 1 — Normal Taxes and Surtaxes (Sections 1 to 1400Z-2)
- Subchapter N — Tax Based on Income From Sources Within or Without the United States (Sections 861 to 999)
- Part III — Income From Sources Without the United States (Sections 901 to 989)
- **Subpart A — Foreign Tax Credit (Sections 901 to 909)**

“The tax imposed by this chapter” means IRC §§1 - 1400Z-2

- Internal Revenue Code (*Title 26 of the United States Code*)
- Subtitle A — Income Taxes (Sections 1 to 1564)
- **Chapter 1 — Normal Taxes and Surtaxes (Sections 1 to 1400Z-2)**
 - Subchapter N — Tax Based on Income From Sources Within or Without the United States (Sections 861 to 999)
 - Part III — Income From Sources Without the United States (Sections 901 to 989)
 - Subpart A — Foreign Tax Credit (Sections 901 to 909)

3. Who is Eligible for the “Deemed Paid” Foreign Tax Credit?

U.S. shareholders of CFCs that are domestic corporations

- **Domestic** - A corporation organized under the laws of the United States, any State, or the District of Columbia. *IRC §7701(a)(4)*.
- **Corporation** - C corporations only. S corporations are treated as partnerships for purposes of foreign tax credit calculations. *IRC §1373(a)*.
- **Check-the-box entities** - Obvs. a domestic eligible entity (i.e., a limited liability company) electing C corporation status (Form 8832) is a domestic corporation for IRC §960 and the “deemed paid” foreign tax credit. *Reg. §301.7701-3(a)*.

IRC §962 election: an individual is treated as a domestic corporation

“ . . . [I]n the case of a United States shareholder who is an individual and who elects to have the provisions of this section apply for the taxable year[,] . . . for purposes of applying the provisions of **section 960** (relating to foreign tax credit) such amounts shall be treated as if they were received by a domestic corporation.”

IRC §962(a)(2).

Individual U.S. shareholders holding CFC stock indirectly

“The election under section 962 may be made only by an individual (including a trust or estate) who is a United States shareholder **(including an individual who is a United States shareholder because, by reason of section 958(b), he is considered to own stock of a foreign corporation owned (within the meaning of section 958(a)) by a domestic pass-through entity (as defined in § 1.965–1(f)(19))**.”

Reg. §1.962-2(a).

4. How IRC §960 Works for Subpart F Income

IRC §960

CFC-level assumptions

- Net income: \$10,000.
- Dividend income, therefore classified as foreign personal holding company income. *IRC §954(c)(1)(A)*.
- Foreign country corporate income tax rate: 30%.
- Foreign country corporate income tax paid: \$3,000.
- Subpart F income for U.S. shareholder: \$7,000.
- Current earnings and profits: \$7,000.

How the subpart F income arrives on Form 1120 as income

16a	Subpart F inclusions derived from the sale by a controlled foreign corporation (CFC) of the stock of a lower-tier foreign corporation treated as a dividend (attach Form(s) 5471) (see instructions)		100	
b	Subpart F inclusions derived from hybrid dividends of tiered corporations (attach Form(s) 5471) (see instructions)			
c	Other inclusions from CFCs under subpart F not included on line 16a, 16b, or 17 (attach Form(s) 5471) (see instructions)	7,000		
17	Global Intangible Low-Taxed Income (GILTI) (attach Form(s) 5471 and Form 8992)			
18	Gross-up for foreign taxes deemed paid	3,000		
19	IC-DISC and former DISC dividends not included on line 1, 2, or 3			
20	Other dividends			
21	Deduction for dividends paid on certain preferred stock of public utilities			
22	Section 250 deduction (attach Form 8993)			
23	Total dividends and inclusions. Add column (a), lines 9 through 20. Enter here and on page 1, line 4	10,000		
24	Total special deductions. Add column (c), lines 9 through 22. Enter here and on page 1, line 29b			

Form **1120** (2022)

5. The Look-Through Rule for IRC §951(a) Income Inclusions

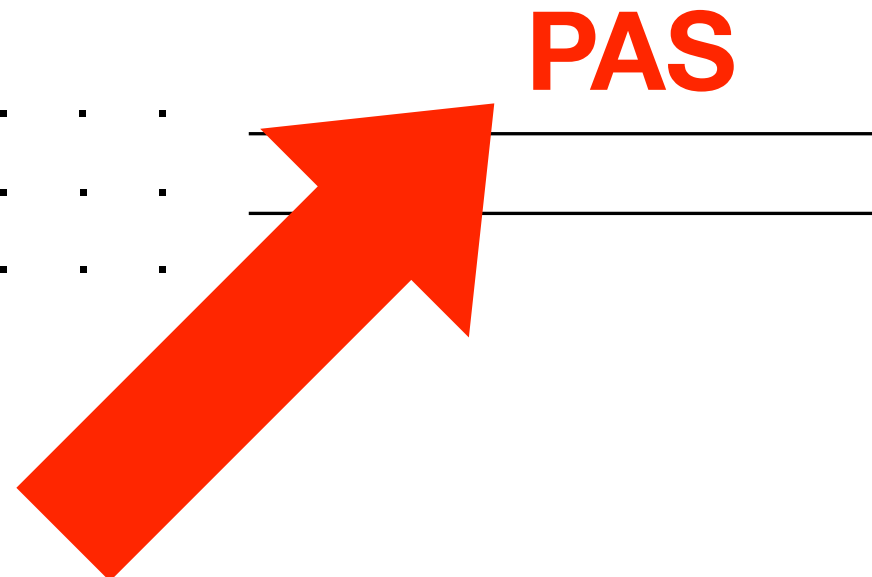
IRC §904(d)(3)(B)

Subpart F income: which category do you choose?

Form 1118 (Rev. December 2022) Department of the Treasury Internal Revenue Service	Foreign Tax Credit—Corporations Attach to the corporation's tax return. Go to www.irs.gov/Form1118 for instructions and the latest information.		OMB No. 1545-0123
	For calendar year 20____, or other tax year beginning _____, 20____, and ending _____, 20____		Attachment Sequence No. 118
Name of corporation			Employer identification number

Use a separate Form 1118 for each applicable category of income (see instructions).

- a Separate Category (Enter code—see instructions)
- b If code 901j is entered on line a, enter the country code for the sanctioned country (see instructions)
- c If one of the RBT codes is entered on line a, enter the country code for the treaty country (see instructions)



PAS

Look-through rule: IRC §904(d)(3)(B)

Which income category do you use for subpart F income?

- Foreign source income is allocated into four categories, and the foreign tax credit limitations are applied to each category separately. *IRC §904(d)(1)*.
- ~~Section 951A inclusions. *IRC §904(d)(1)(A)*.~~
- ~~Foreign branch income. *IRC §904(d)(1)(B)*.~~
- Passive category income. *IRC §904(d)(1)(C)*.
- General category income. *IRC §904(d)(1)(D)*.

IRC §904(d)(3): the look-through rule

- Instructions for Form 1118 (rev. 12-2022), page 5.
- Subpart F income is allocated to passive category income and if it isn't passive category income, to general category income or one of the "specified separate categories" in Reg. §1.904-4(m).

Look-Through Rules

CFCs. Generally, dividends, interest, rents, and royalties received or accrued by the taxpayer are passive category income. However, if these items are received or accrued by a 10% (0.10) U.S. shareholder from a CFC, they may be assigned to other separate categories, or may be treated as passive category income under the look-through rules of section 904(d)(3). Dividends include any amount included in gross income under section 951(a)(1)(B).

Look-through rules also apply to subpart F inclusions under section 951(a)(1)(A) and GILTI inclusions under section 951A(a) to the extent attributable to income of the CFC in the passive category.

For more information and examples, see section 904(d)(3) and Regulations section 1.904-5.

Subpart F income: passive category if attributed to passive income

“Any amount included in gross income under section 951(a)(1)(A) shall be treated as passive category income to the extent the amount so included is **attributable** to passive category income.”

IRC §904(d)(3)(B).

How to allocate subpart F income between passive and general

“Any amount included in gross income under section 951(a)(1)(A) is treated as **passive category income** to the extent the amount included is attributable to income received or accrued by the controlled foreign corporation that is passive category income. All other amounts included in gross income under section 951(a)(1)(A) are treated as **general category income** or income in a specified separate category under the rules in § 1.904-4. * * * *”

Reg. §1.904-5(c)(5).

“Passive category income” means “passive income” (and other stuff)

“The term passive category income means passive income and specified passive category income.”

Reg. §1.904-4(b)(1).

What is “passive income” as part of subpart F income?

1. “Income received or accrued by any person that is of a kind that would be **foreign personal holding company income** (as defined in section 954(c), taking into account any exceptions or exclusions to section 954(c), including, for example, section 954(c)(3), (c)(6), (h), or (i)) if the taxpayer were a controlled foreign corporation, including any amount of gain on the sale or exchange of stock in excess of the amount treated as a dividend under section 1248[.]” *Reg. §1.904-4(b)(2)(i)(A)*.
2. Income treated as passive category income under the **look-through rules in § 1.904-5**. *Reg. §1.904-4(b)(2)(i)(D)*.

Form 5471, Schedule I, line 1e: passive category income

Schedule I Summary of Shareholder's Income From Foreign Corporation (see instructions)

If item H on page 1 is completed, a separate Schedule I must be filed for each Category 4, 5a, or 5b filer for whom reporting is furnished on this Form 5471. This Schedule I is being completed for:

Name of U.S. shareholder	Identifying number	
1a Section 964(e)(4) subpart F dividend income from the sale of stock of a lower-tier foreign corporation (see instructions)	1a	
b Section 245A(e)(2) subpart F income from hybrid dividends of tiered corporations (see instructions)	1b	
c Subpart F income from tiered extraordinary disposition amounts not eligible for subpart F exception under section 954(c)(6)	1c	
d Subpart F income from tiered extraordinary reduction amounts not eligible for subpart F exception under section 954(c)(6)	1d	
e Section 954(c) Subpart F Foreign Personal Holding Company Income (enter result from Worksheet A)	1e	Passive
f Section 954(d) Subpart F Foreign Base Company Sales Income (enter result from Worksheet A)	1f	
g Section 954(e) Subpart F Foreign Base Company Services Income (enter result from Worksheet A)	1g	
h Other subpart F income (enter result from Worksheet A)	1h	
2 Earnings invested in U.S. property (enter the result from Worksheet B)	2	
3 Reserved for future use	3	
4 Factoring income	4	
See instructions for reporting amounts on lines 1, 2, and 4 on your income tax return.		
5a Section 245A eligible dividends (see instructions)	5a	
b Extraordinary disposition amounts (see instructions)	5b	
c Extraordinary reduction amounts (see instructions)	5c	
d Section 245A(e) dividends (see instructions).	5d	
e Dividends not reported on line 5a, 5b, 5c, or 5d	5e	
6 Exchange gain or (loss) on a distribution of previously taxed earnings and profits	6	

Today's example: it's all passive category income

	Subpart F Income	Passive Category Income	General Category Income
Foreign personal holding company income	7,000	7,000	0
Total subpart F income	7,000	7,000	0

Multiple categories: Reg. §1.904-5(c)(7)(i), Example 1

	Subpart F Income	Passive Category Income	General Category Income
Foreign personal holding company income	15	15	
Foreign base company sales income	85		85
Total subpart F income	100	15	85

6. The IRC §78 Gross-Up

Foreign tax credit? Or treat foreign taxes as a deduction?

- Take a deduction for the income tax paid by the CFC
- Gross income: \$10,000 net income - \$3,000 foreign income tax paid by the CFC = \$7,000 subpart F income. U.S. parent corporation pays income tax on that that.
- Take a foreign tax credit
- Gross income: \$10,000 pre-tax net income, then claim a tax credit for the foreign taxes paid.

Why you want to use the deemed paid foreign tax credit

	No Foreign Tax Credit	With Foreign Tax Credit
CFC net income	10,000	10,000
Less taxes paid	(3,000)	(3,000)
Plus IRC §78 gross-up	N/A	3,000
<i>Parent corporation taxable income</i>	<i>7,000</i>	<i>10,000</i>
Parent corporation income tax (21%)	1,470	2,100
Less foreign tax credit	0	(2,100)
Parent corporation net income tax liability	1,470	0

IRC §78 gross-up: a “dividend”

“If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, **an amount equal to the taxes deemed to be paid** by such corporation under subsections (a), (b), and (d) of section 960 (determined without regard to the phrase “80 percent of” in subsection (d)(1) thereof) for such taxable year shall be treated for purposes of this title (other than sections 245 and 245A) **as a dividend** received by such domestic corporation from the foreign corporation.”

IRC §78.

IRC §78 gross-up dividend is not a dividend for foreign tax credit

“For purposes of this paragraph, the term “dividend” includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but **shall be treated as included in gross income under section 951(a)(1)(A).**”

IRC §904(d)(3)(G).

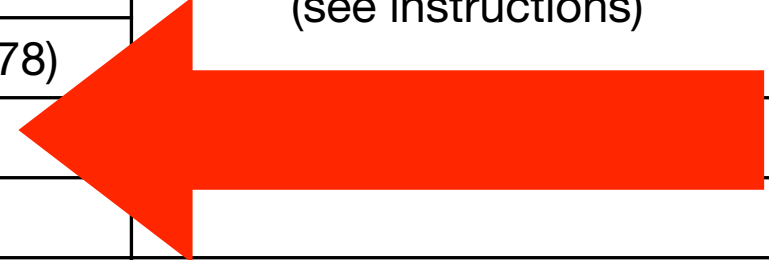
How the IRC §78 gross-up dividend arrives on Form 1120 as income

16a	Subpart F inclusions derived from the sale by a controlled foreign corporation (CFC) of the stock of a lower-tier foreign corporation treated as a dividend (attach Form(s) 5471) (see instructions)		100	
b	Subpart F inclusions derived from hybrid dividends of tiered corporations (attach Form(s) 5471) (see instructions)			
c	Other inclusions from CFCs under subpart F not included on line 16a, 16b, or 17 (attach Form(s) 5471) (see instructions)	7,000		
17	Global Intangible Low-Taxed Income (GILTI) (attach Form(s) 5471 and Form 8992)			
18	Gross-up for foreign taxes deemed paid	3,000		
19	IC-DISC and former DISC dividends not included on line 1, 2, or 3			
20	Other dividends			
21	Deduction for dividends paid on certain preferred stock of public utilities			
22	Section 250 deduction (attach Form 8993)			
23	Total dividends and inclusions. Add column (a), lines 9 through 20. Enter here and on page 1, line 4	10,000		
24	Total special deductions. Add column (c), lines 9 through 22. Enter here and on page 1, line 29b			

Form **1120** (2022)

The IRC §78 gross-up on Form 1118

Schedule A Income or (Loss) Before Adjustments (Report all amounts in U.S. dollars. See Specific Instructions .)							
	1. EIN or Reference ID Number (see instructions)*		2. Foreign Country or U.S. Possession (enter two-letter code— use a separate line for each) (see instructions)	Gross Income or (Loss) From Sources Outside the United States			
				3. Inclusions Under Sections 951(a)(1) and 951A (see instructions)		4. Dividends (see instructions)	5. Interest
				(a) Exclude Gross-Up	(b) Gross-Up (section 78)		
A				7,000	3,000		
B							
C							
Totals (add lines A through C)							
	6. Gross Rents, Royalties, and License Fees	7. Sales	8. Gross Income From Performance of Services	9. Currency Gain	10. Currency Gain Code (see instructions)	11. Other (attach schedule)	12. Total (add columns 3(a) through 9 and 11)
A							10,000
B							
C							
Totals							



7. Computing the Allowable Foreign Tax Credit

“Deemed paid” (IRC §960) —> credit allowable (IRC §§901, 904)

- After you have decided how much of the CFC’s tax liability the United States shareholder is deemed to have paid, you take that number and apply the limitations of IRC §§901 and 904.
- Basic concept: within income categories, the amount of foreign tax credit allowable is the lower number of these two:
 - The U.S. income tax liability; or
 - The foreign tax credit paid or deemed paid.

Form 1118, Schedule A: total passive category income

Schedule A							
Income or (Loss) Before Adjustments (Report all amounts in U.S. dollars. See Specific Instructions.)							
1. EIN or Reference ID Number (see instructions)*	2. Foreign Country or U.S. Possession (enter two-letter code—use a separate line for each) (see instructions)	Gross Income or (Loss) From Sources Outside the United States					
		3. Inclusions Under Sections 951(a)(1) and 951A (see instructions)		4. Dividends (see instructions)	5. Interest		
		(a) Exclude Gross-Up	(b) Gross-Up (section 78)				
A			7,000	3,000			
B							
C							
Totals (add lines A through C)							
6. Gross Rents, Royalties, and License Fees	7. Sales	8. Gross Income From Performance of Services	9. Currency Gain	10. Currency Gain Code (see instructions)	11. Other (attach schedule)	12. Total (add columns 3(a) through 9 and 11)	
A							10,000
B							
C							
Totals							
13. Allocable Deductions							17. Total Income or (Loss) Before Adjustments (subtract column 16 from column 12)
(a) Dividends Received Deduction (see instructions)	(b) Deduction Allowed Under Section 250(a)(1)(A)—Foreign Derived Intangible Income	(c) Deduction Allowed Under Section 250(a)(1)(B)—Global Intangible Low-Taxed Income	Rental, Royalty, and Licensing Expenses		(f) Expenses Allocable to Sales Income	(g) Expenses Allocable to Gross Income From Performance of Services	
			(d) Depreciation, Depletion, and Amortization	(e) Other Allocable Expenses			
A							
B							
C							
Totals							
13. Allocable Deductions (continued)				14. Apportioned Share of Deductions (enter amount from applicable line of Schedule H, Part I, column (b); Part II, column (f); and Part III, column (g))	15. Net Operating Loss Deduction	16. Total Deductions (add columns 13(k) through 15)	17. Total Income or (Loss) Before Adjustments (subtract column 16 from column 12)
(h) Currency Loss	(i) Currency Loss Code (see instructions)	(j) Other Allocable Deductions (attach schedule) (see instructions)	(k) Total Allocable Deductions (add columns 13(a) through 13(h) and 13(j))				
A							10,000
B							
C							
Totals							

*For section 863(b) income, NOLs, income from RICs, high-taxed income, section 951A, and reattribution of income by reason of disregarded payments, use a single line (see instructions). Also, for reporting branches that are QBUs, use a separate line for each such branch.

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 10900F

Form **1118** (Rev. 12-2022)

Form 1118, Schedule B, Part II applies the limitations

Form 1118 (Rev. 12-2022)

Page **2**

Schedule B Foreign Tax Credit (Report all foreign tax amounts in U.S. dollars.)

Part I—Foreign Taxes Paid, Accrued, and Deemed Paid (see instructions)

1. Credit Is Claimed for Taxes (check one):		2. Foreign Taxes Paid or Accrued (attach schedule showing amounts in foreign currency and conversion rate(s) used)					
<input checked="" type="checkbox"/> Paid <input type="checkbox"/> Accrued		Tax Withheld at Source on:					
Date Paid	Date Accrued	(a) Dividends	(b) Distributions of Previously Taxed Earnings and Profits	(c) Branch Remittances	(d) Interest	(e) Rents, Royalties, and License Fees	(f) Other
A							
B							
C							
Totals (add lines A through C)							
2. Foreign Taxes Paid or Accrued (attach schedule showing amounts in foreign currency and conversion rate(s) used) (continued)							3. Tax Deemed Paid (see instructions)
Other Foreign Taxes Paid or Accrued on:			(j) Total Foreign Taxes Paid or Accrued (add columns 2(a) through 2(i))				
(g) Sales	(h) Services Income	(i) Other					
A							3,000
B							
C							
Totals							

Part II—Separate Foreign Tax Credit (Complete a separate Part II for each applicable category of income.)

1a	Total foreign taxes paid or accrued (total from Part I, column 2(j))	1a		
1b	Foreign taxes paid or accrued by the corporation during prior tax years that were suspended due to the rules of section 909 and for which the related income is taken into account by the corporation during the current tax year (see instructions)	1b		
2	Total taxes deemed paid (total from Part I, column 3)	2	3,000	
3	Reductions of taxes paid, accrued, or deemed paid (enter total from Schedule G, Part I)	3	()	
4	Taxes reclassified under high-tax kickout	4		
5	Enter the sum of any carryover of foreign taxes (from Schedule K, line 3, column (xiv), and from Schedule I, Part III, line 3) plus any carrybacks to the current tax year	5		
6	Total foreign taxes (combine lines 1a through 5)	6	3,000	
7	Enter the amount from the applicable column of Schedule J, Part I, line 11 (see instructions). If Schedule J is not required to be completed, enter the result from the "Totals" line of column 17 of the applicable Schedule A	7	10,000	
8a	Total taxable income from all sources (enter taxable income from the corporation's tax return)	8a	10,000	
8b	Adjustments to line 8a (see instructions)	8b		
8c	Subtract line 8b from line 8a	8c	10,000	
9	Divide line 7 by line 8c. Enter the resulting fraction as a decimal (see instructions). If line 7 is greater than line 8c, enter 1	9	1	
10	Total U.S. income tax against which credit is allowed (regular tax liability (see section 26(b)) minus any American Samoa economic development credit)	10	2,100	
11	Multiply line 9 by line 10	11	2,100	
12	Increase in limitation (section 960(c))	12		
13	Credit limitation (add lines 11 and 12) (see instructions)	13	2,100	
14	Separate foreign tax credit (enter the smaller of line 6 or line 13). Enter here and on the appropriate line of Part III	14	2,100	

Form **1118** (Rev. 12-2022)

8. Conclusion

Conclusion

- Usually, only the taxpayer who actually owed and paid the foreign income tax can claim the foreign tax credit.
- Domestic corporations which are United States shareholders of controlled foreign corporations can claim the “deemed paid” foreign tax credit for foreign corporate income tax paid by the CFC.
- Individual United States shareholders who make the Section 962 election can, too.
- This offsets the United States shareholder’s U.S. income tax liability for gross income inclusions of subpart F income and Global Intangible Low-Taxed Income.

Follow-up? Questions? Comments?

Philip D. W. Hodgen

HodgenLaw PC
140 South Lake Avenue, Suite 230
Pasadena, California 91101
www.hodgen.com
w: +1 626 689 0060
phil@hodgen.com

Disclaimer

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