The United States imposes U.S. federal income tax on its citizens and residents on all income whether earned at home or abroad. In order to alleviate the double-taxation burden associated with this worldwide tax system, the government generally permits U.S. taxpayers to claim a credit for income taxes paid or accrued to foreign countries, and therefore allows those U.S. taxpayers to reduce U.S. tax paid on foreign income by the amount of foreign taxes paid on that income. Taxpayers may pay residual tax on foreign-source income if the foreign tax rate is less than the U.S. tax rate.

The ability to take this foreign tax credit (FTC) is subject to complex limitation rules. These rules were significantly modified by the Tax Cuts and Jobs Act of 2017 (TCJA; P.L. 115-97). FTC final regulations and proposed regulations released in December 2019 by the U.S. Treasury Department and Internal Revenue Service provide the detailed rules required to implement the TCJA changes. Peppered throughout these new complex rules are numerous new elections and method change opportunities. These changes may provide significant tax benefits, but in most cases taxpayers will need to analyze the impact of the new rules to maximize their foreign tax credit.

Who can benefit from FTC planning?

The FTC rules apply broadly across multiple industries, sectors and taxpayer types. RSM’s FTC planning and reporting services can be beneficial for any business subject to foreign tax whether through direct cross-border operations or through the operations of subsidiaries and disregarded entities. These services are particularly beneficial to businesses that are:

- Experiencing increased liquidity needs
- Planning or undergoing structural changes
- Opening new markets or are looking to expand into a foreign country

Opportunities and risks

Computing the FTC requires a significant amount of information and is complex. However, understanding and modeling the impact the new FTC rules will have on your organization may maximize planning opportunities, minimize risk and increase liquidity.

How RSM can help

RSM has developed tools to help perform the complicated calculations necessary in order to determine a taxpayer’s FTC limitation, foreign expense allocation and overall loss balances to support the company’s financial reporting position regarding its FTCs.

Moreover, the economic consequences of the COVID–19 pandemic have left many companies and their owners struggling to meet liquidity needs. To help clients increase cash flows, RSM has established a comprehensive process and service delivery approach for assisting taxpayers in maximizing their FTC benefits through:

- Obtaining prior-year amended return refunds
- Planning options for shielding income pickup
- Planning transactions that trigger tax but are offset by foreign tax

There are many aspects to consider in calculating the foreign tax credit, including eligibility, limitations, income/loss allocations, the impact of making or revoking certain elections, and the impact on the global effective tax rate. Having a thorough understanding of all these variables and how they interact can help you make better decisions.