



IRS Nationwide

Tax Forum | 2022

Foreign Tax Credit (Form 1116) & Common Errors July 27, 2022

Start Time: 11:00pm Eastern / 10:00am Central
9:00am Mountain / 8:00am Pacific

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TaxForum

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2022

Today our webinar will:

- Explain the basic requirements for claiming a foreign tax credit (“FTC”)
- Identify common errors found on Form 1116 and related schedules
- Explain the impact of the Tax Cuts and Jobs Act on FTC



Foreign Tax Credit Concepts (1 of 3)

- Foreign tax credit (FTC) mitigates the effect of potential double taxation on foreign source income taxed once by the foreign country and once by the U.S.
- FTC reduces a U.S. taxpayer's U.S. tax liability by all, or part of foreign taxes paid or accrued during a tax year by allowing a dollar-for-dollar credit against U.S. taxes for taxes imposed by the foreign country
- Determining the source of income as U.S. or foreign source is necessary to correctly compute the FTC

Foreign Tax Credit Concepts (2 of 3)

<p>Form 1116</p> <p>Department of the Treasury Internal Revenue Service (99)</p>	<p>Foreign Tax Credit (Individual, Estate, or Trust)</p> <p>▶ Attach to Form 1040, 1040-SR, 1040-NR, 1041, or 990-T. ▶ Go to www.irs.gov/Form1116 for instructions and the latest information.</p>	<p>OMB No. 1545-0121</p> <p>2021 Attachment Sequence No. 19</p>			
<p>Name _____</p>		<p>Identifying number as shown on page 1 of your tax return _____</p>			
<p>Use a separate Form 1116 for each category of income listed below. See <i>Categories of Income</i> in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.</p>					
<p> <input type="checkbox"/> a Section 951A category income <input type="checkbox"/> c Passive category income <input type="checkbox"/> e Section 901(j) income <input type="checkbox"/> g Lump-sum distributions <input type="checkbox"/> b Foreign branch category income <input type="checkbox"/> d General category income <input type="checkbox"/> f Certain income re-sourced by treaty </p>					
<p>h Resident of (name of country) ▶ _____</p>					
<p>Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.</p>					
<p>Part I Taxable Income or Loss From Sources Outside the United States (for category checked above)</p>					
<p>i Enter the name of the foreign country or U.S. possession ▶ _____</p> <p>1a Gross income from sources within country shown above and of the type checked above (see instructions): _____</p>	<p>Foreign Country or U.S. Possession</p>				<p>Total (Add cols. A, B, and C.)</p>
	<p>A</p>	<p>B</p>	<p>C</p>		



Foreign Tax Credit Concepts (3 of 3)

- Generally, the following four tests must be met for any foreign tax to qualify for the credit. The tax must be:
 - an income tax, or a tax imposed in lieu of an income tax,
 - the legal and actual foreign tax liability,
 - tax imposed on the taxpayer and
 - tax paid or accrued by the taxpayer.



Treaty Rates vs Statutory Withholding Rates (1 of 2)

- The U.S. has income tax treaties with over 60 countries
- Tax treaties establish specific withholding rates for certain types of income, generally passive, such as interest, rents, royalties, and dividends
- Treaty rates may be used by taxpayers to reduce the amount of foreign taxes they pay to the foreign country



Treaty Rates vs Statutory Withholding Rates (2 of 2)

- The statutory withholding rate is the rate of tax withheld on certain types of income based on the internal tax laws of particular countries
- If a treaty is in place with a foreign country, taxpayers must use the lower treaty rate instead of the higher statutory withholding rate to compute FTC.



Statutory Withholding Rates

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1a Total ordinary dividends	OMB No. 1545-0110	2021	Dividends and Distributions
		\$	Form 1099-DIV		
		1b Qualified dividends			
		\$			
		2a Total capital gain distr.	2b Unrecap. Sec. 1250 gain		Copy B For Recipient
		\$	\$		
PAYER'S TIN	RECIPIENT'S TIN	2c Section 1202 gain	2d Collectibles (28%) gain		
		\$	\$		
		2e Section 897 ordinary dividends	2f Section 897 capital gain		
		\$	\$		
RECIPIENT'S name		3 Nondividend distributions	4 Federal income tax withheld		
		\$	\$		
Street address (including apt. no.)		5 Section 199A dividends	6 Investment expenses		
		\$	\$		
City or town, state or province, country, and ZIP or foreign postal code		7 Foreign tax paid	8 Foreign country or U.S. possession		
		\$			
		9 Cash liquidation distributions	10 Noncash liquidation distributions		
		\$	\$		
		11 Exempt-interest dividends	12 Specified private activity bond interest dividends		
		\$	\$		
Account number (see instructions)		13 State	14 State identification no.	15 State tax withheld	
				\$	
				\$	

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1116 – Foreign Taxes Paid

Part II Foreign Taxes Paid or Accrued (see instructions)											
Country	Credit is claimed for taxes (you must check one) (j) <input type="checkbox"/> Paid (k) <input type="checkbox"/> Accrued	Foreign taxes paid or accrued									
		In foreign currency				In U.S. dollars					
	(l) Date paid or accrued	Taxes withheld at source on:			(p) Other foreign taxes paid or accrued	Taxes withheld at source on:			(t) Other foreign taxes paid or accrued	(u) Total foreign taxes paid or accrued (add cols. (q) through (t))	
		(m) Dividends	(n) Rents and royalties	(o) Interest		(q) Dividends	(r) Rents and royalties	(s) Interest			
A	12/31/2021	\$XX,XXX				\$X,XXX				\$X,XXX	
B											
C											
8 Add lines A through C, column (u). Enter the total here and on line 9, page 2 ▶										8	\$X,XXX

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11440U

Form 1116 (2021)

Example 1: Treaty Rates vs. Statutory Withholding Rates

Taxpayer A earns \$10,000 of interest income from Foreign Country B. Tax is withheld at a rate of 30% but the treaty rate is 10%.

- Statutory Withholding rate ($\$10,000 \times 30\%$) \$3,000
- Reduced Withholding rate ($\$10,000 \times 10\%$) \$1,000
- **Creditable Foreign Taxes** **\$1,000**

Example 2: Treaty Rates vs. Statutory Withholding Rates (1 of 3)

Taxpayer B receives Form 1099-DIV reporting total dividends of \$20,000 and foreign taxes withheld of \$6,000. The foreign country is listed as “various”.

Actually, the \$20,000 in dividends consist of:

- \$10,000 in dividends from Country C (treaty rate of 15% for dividends) and
- \$10,000 in dividends from Country D (treaty rate of 0% for dividends)



Example 2: Treaty Rates vs. Statutory Withholding Rates (2 of 3)

Taxpayer B's Form 1116 list \$6,000 in foreign taxes paid on foreign dividends and the country as "various"

Taxpayer B incorrectly reported the amount of creditable foreign taxes. The correct reporting is:

- Each foreign country should have been identified on the Form 1116
- The creditable foreign taxes should have been claimed based on the treaty rate, not the statutory withholding rate

Example 2: Treaty Rates vs. Statutory Withholding Rates (3 of 3)

Taxpayer B's correct foreign taxes paid:

Country	Dividends Received	Foreign Taxes Paid (Treaty Rate)
C	\$10,000	\$1,500
D	\$10,000	\$0
	Foreign Taxes Allowed	\$1,500



Form 1116 Part I Common Errors (1 of 2)

- Form 1116 Part I
 - Names of foreign countries
 - FEIE adjustment to foreign income and corresponding reduction to foreign taxes
 - Qualified dividends and capital gains adjustment
- Definitely related expenses vs. not definitely related expenses

Form 1116 Part I Common Errors (2 of 2)

Form **1116** **Foreign Tax Credit** (Individual, Estate, or Trust)
 Department of the Treasury Internal Revenue Service (999) **2021** Attachment Sequence No. 19
 OMB No. 1545-0121
 Attach to Form 1040, 1040-SR, 1040-NR, 1041, or 990-T. Go to www.irs.gov/Form1116 for instructions and the latest information.

Name _____ Identifying number as shown on page 1 of your tax return _____

Use a separate Form 1116 for each category of income listed below. See *Categories of Income* in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

a Section 951A category income c Passive category income e Section 901(g) income g Lump-sum distributions
 b Foreign branch category income d General category income f Certain income re-sourced by treaty

h Resident of (name of country) ▶ _____

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I Taxable Income or Loss From Sources Outside the United States (for category checked above)

i	Enter the name of the foreign country or U.S. possession ▶	Foreign Country or U.S. Possession			Total (Add cols. A, B, and C.)
		A	B	C	
1a	Gross income from sources within country shown above and of the type checked above (see instructions): Line 1a: FEIE, QD/CG Reductions				1a
Deductions and losses (Caution: See instructions.):					
2	Expenses definitely related to the income on line 1a (attach statement) ▶				
3	Pro rata share of other deductions not definitely related:				
a	Certain itemized deductions or standard deduction (see instructions)				
b	Other deductions (attach statement)				
c	Add lines 3a and 3b				
d	Gross foreign source income (see instructions)				
e	Gross income from all sources (see instructions)				
f	Divide line 3d by line 3e (see instructions)				
g	Multiply line 3c by line 3f				
4	Pro rata share of interest expense (see instructions):				
a	Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions)				
b	Other interest expense				
5	Losses from foreign sources				
6	Add lines 2, 3g, 4a, 4b, and 5				6
7	Subtract line 6 from line 1a. Enter the result here and on line 15, page 2 ▶				7



Form 1116 Part I Common Errors Example

2021 Gross foreign salary	\$150,000
Foreign Income Excluded IRC 911	(\$108,700)
	<hr/>
Form 1116 line 1a	\$ 41,300



Form 1116 Part II Common Errors (1 of 2)

- Basis for claiming the credit
 - Paid
 - Accrued
- General foreign currency rules
 - Paid (cash) method, convert foreign currency using the rate on date of payment of the taxes to the foreign country
 - Accrued method, convert foreign currency using average exchange rate for the tax year to which the taxes relate

Form 1116 Part II Common Errors (2 of 2)

Part II Foreign Taxes Paid or Accrued (see instructions)									
Country	Credit is claimed for taxes (you must check one)		Foreign taxes paid or accrued						
	(j) <input type="checkbox"/> Paid (k) <input type="checkbox"/> Accrued		In foreign currency				In U.S. dollars		
			Taxes withheld at source on:			(p) Other foreign taxes paid or accrued	Taxes withheld at source on:		(t) Other foreign taxes paid or accrued
	(l) Date paid or accrued	(m) Dividends	(n) Rents and royalties	(o) Interest		(q) Dividends	(r) Rents and royalties	(s) Interest	
A	12/31/2021	\$XX,XXX				\$X,XXX			\$X,XXX
B									
C									
8 Add lines A through C, column (u). Enter the total here and on line 9, page 2								8	\$X,XXX

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Form 1116 Part III Common Errors

- Line 12 reduction in foreign taxes
- Line 16 adjustment to foreign income
 - Allocation of foreign and domestic losses
 - Recapture of prior year loss accounts
- Line 18 adjustment to U.S. taxable income
 - Qualified dividends/capital gains



Part III Common Errors Example (1 of 2)

Taxpayer A paid \$45,000 on gross foreign salary of \$150,000

\$108,700 IRC 911 FEIE

\$150,000 Gross salary

$$X \$45,000 = \$32,610$$

Part III Common Errors Example (2 of 2)

Form 1116 (2021) Page 2

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I . . .	9	
10	Enter the sum of any carryover of foreign taxes (from Schedule B, line 3, column (xiv)) plus any carrybacks to the current tax year (If your income was section 951A category income (box a above Part I), leave line 10 blank.)	10	
11	Add lines 9 and 10	11	
12	Reduction in foreign taxes (see instructions)	12	(32,610)



Common Errors line 16 (1 of 2)

- Adjustments to line 16 include:
 - Allocation of foreign losses
 - Allocation of U.S. losses
 - Recapture of separate limitation loss accounts
- A complete list can be found in the Instructions for Form 1116

Common Errors line 16 (2 of 2)

Form 1116 (2021) Page **2**

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I . . .	9		
10	Enter the sum of any carryover of foreign taxes (from Schedule B, line 3, column (xiv)) plus any carrybacks to the current tax year (If your income was section 951A category income (box a above Part I), leave line 10 blank.)	10		
11	Add lines 9 and 10	11		
12	Reduction in foreign taxes (see instructions)	12	()	
13	Taxes reclassified under high tax kickout (see instructions)	13		
14	Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit	14		
15	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I. See instructions	15		
16	Adjustments to line 15 (see instructions)	16		



Common Errors Line 18

- An adjustment may be required if total income includes qualified dividends and/or capital gains

Form 1116 (2021) Page **2**

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I	9		
10	Enter the sum of any carryover of foreign taxes (from Schedule B, line 3, column (xiv)) plus any carrybacks to the current tax year (If your income was section 951A category income (box a above Part I), leave line 10 blank.)	10		
11	Add lines 9 and 10	11		
12	Reduction in foreign taxes (see instructions)	12	()	
13	Taxes reclassified under high tax kickout (see instructions)	13		
14	Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit	14		
15	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I. See instructions	15		
16	Adjustments to line 15 (see instructions)	16		
17	Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 24. However, if you are filing more than one Form 1116, you must complete line 20.)	17		
18	Individuals: Enter the amount from line 15 of your Form 1040, 1040-SR, or 1040-NR. Estates and trusts: Enter your taxable income without the deduction for your exemption	18		



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Form 1116 Part IV Common Errors (1 of 2)

- Complete Part IV if including more than one Form 1116 for separate categories of income
- Complete Part IV on the Form 1116 with the largest amount on line 24

Form 1116 Part IV Common Errors (2 of 2)

24	Enter the smaller of line 14 or line 23. If this is the only Form 1116 you are filing, skip lines 25 through 32 and enter this amount on line 29. Otherwise, complete the appropriate line in Part IV. See instructions.				24
Part IV Summary of Credits From Separate Parts III (see instructions)					
25	Credit for taxes on section 951A category income	25			
26	Credit for taxes on foreign branch category income	26			
27	Credit for taxes on passive category income	27			
28	Credit for taxes on general category income	28			
29	Credit for taxes on section 901(j) income	29			
30	Credit for taxes on certain income re-sourced by treaty	30			
31	Credit for taxes on lump-sum distributions	31			
32	Add lines 25 through 31			32	
33	Enter the smaller of line 20 or line 32			33	
34	Reduction of credit for international boycott operations. See instructions for line 12			34	
35	Subtract line 34 from line 33. This is your foreign tax credit . Enter here and on Schedule 3 (Form 1040), line 1; Form 1041, Schedule G, line 2a; or Form 990-T, Part III, line 1a ▶			35	



TCJA Impact

- Two additional separate limitation categories of income
 - IRC 951A income (global intangible low-taxed income (GILTI))
 - Foreign Branch income
- Carryback and carryover rule under IRC 904(c) does not apply to GILTI income
- FTC limited to 80% of foreign taxes with respect to GILTI



Form 1116 New Schedules

- Form 1116 Schedule B
 - Reconcile prior year foreign tax carryover with current year carryover
- Form 1116 Schedule C
 - Identify current year foreign tax redeterminations (FTRs), the years to which they relate and other information that satisfies the obligation to notify IRS



IRS Publications and Additional Resources

- Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*
- Publication 514, *Foreign Tax Credit for Individuals*
- Publication 901, *U.S. Tax Treaties*
- Form 1116 and Form 1116 Instructions
- <https://www.youtube.com/watch?v=ph8A1eA1lq4>



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Thank You For Attending

- The Virtual Nationwide Tax Forum will take place on Tuesdays, Wednesdays, and Thursdays between July 19th and August 18th. For more information visit www.irstaxforum.com.
- You must complete the survey within the allotted three minutes and before you log off of the webinar to be eligible for CE credit.
- Certificates of Completion will be emailed to attendees within two weeks of the conclusion of the 2022 Virtual IRS Nationwide Tax Forum at the end of August. CE Certificates will provide a summary of all Virtual Tax Forum webinars successfully attended by the individual.
- Questions or Concerns? Email us at info@irstaxforum.com.