CREDIT FOR FOREIGN TAXES PAID NOT AVAILABLE AGAINST NEW 3.8% NET INVESTMENT INCOME TAX

Smarter Way to Cross Blog Archives
February 4, 2014

Attorneys

James Bandoblu Jr.

Previously, many U.S. citizens living abroad eliminated their U.S. income tax liabilities with a credit for foreign taxes paid; however, individuals who are subject to the new 3.8 percent net investment income tax (NIIT) may now owe U.S. income tax, some for the first time. Recently, the IRS released final Treasury regulations (TD 9644) for the NIIT and those regulations confirmed that taxpayers cannot offset the NIIT with a credit for foreign taxes paid. Treas. Reg. § 1.1411-1(e)

The NIIT applies to a U.S. taxpayer whose modified adjusted gross income (MAGI) is at least $200,000 (a single filer) or $250,000 (joint filers). The taxable amount is the lesser of (1) the excess MAGI over the taxpayer's threshold and (2) the taxpayer's net investment income, which includes interest, dividends, capital gains, rental and royalty income, income from businesses involved in trading financial instruments or commodities, and income from businesses that are passive activities to the taxpayer.

Prior to the issuance of the final regulations, there was some question as to whether a credit for foreign taxes paid could offset the NIIT (and whether Congress intended that result), although denial of the credit seemed clear based on the NIIT's placement in the Internal Revenue Code (the "Code") (under the Code, a foreign tax credit offsets only a chapter 1 tax, and the NIIT falls under chapter 2A of the Code). The final regulations, however, explicitly confirm that foreign taxes cannot offset the NIIT; and, at the present time, there is not a provision in the U.S.-Canada Income Tax Treaty that would override the regulations. Thus, beginning with 2013 U.S. tax filings, some nonresident U.S. taxpayers who historically paid no U.S. income tax may find themselves with U.S. income tax liabilities for the first time.