OB3 Impacts

Foreign Tax Credit Changes

November 19, 2025

OB3 Impacts Webinar Series

1. [CFC Income Updates and BEAT Planning]
2. [FDDEI Mechanics & Modeling]
3. **Foreign Tax Credit Changes**
4. ASC 740 Impacts (12/3)
5. Tax Planning Opportunities (12/10)

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Today's Presenters

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Agenda

1. Foreign Tax Credit (FTC) Overview
2. OB3 Reforms to the FTC Regime
3. Impact of OB3 on Domestic Provisions and FTC Modeling

01

Overview of the FTC

FTC General Synopsis

Purpose: To avoid double taxation when the same income is taxed abroad and in the U.S.

Who Can Claim: U.S. individuals and corporations with **foreign-source income** that is also subject to U.S. tax.

Form Used: Typically **Form 1116** (individuals), **Form K-3** (pass through entities) or **Form 1118** (corporations).

Common baskets of income under Section 904(d):

1. **General Basket –** Includes active business income earned abroad (US company selling goods or services to foreign parties)
2. **Passive Basket–** Includes dividends, interest, rents, royalties from sources outside of the US, and notably Subpart F Inclusions
3. **Foreign Branch Basket–** Includes income attributable to a foreign branch of a US person (US company owns a FDRE)
4. **GILTI/NCTI Basket –** allows taxpayers a credit for deemed paid taxes on GILTI inclusions. Limited to 80% of foreign taxes paid, no carryforward provisions apply

FTC Utilization

FTC Utilization = Lesser of (a) FTC paid or accrued OR (b) FTC limitation

FTCs Paid or Accrued

1. Foreign withholding taxes on foreign source income
2. Foreign taxes paid on Subpart F income
3. Foreign withholding taxes on distributions of previously taxed E&P
4. Foreign taxes paid on tested income (i.e. GILTI / NCTI)
5. Foreign taxes paid in lieu of foreign source income
6. Foreign tax credit carryforwards from prior tax years

FTC Limitation - US Tax Liability for foreign source income:

FTC Limit (per basket) = US Tax Liability x Foreign-Source Taxable Income (per basket) / Worldwide Taxable Income

FTC Utilization

Steps for FTC Utilization

1. Calculate gross income
2. Determine proper sourcing of income
3. Compute Sec. 163(j) limitation and special deductions
4. Assess foreign income taxes paid or accrued
5. Allocate and apportion US deductions
6. Allocate any separate limitation losses (SLL), overall foreign losses (OFL), overall domestic losses (ODL)
7. Recapture any SLL, OFL, ODL accounts
8. Determine FTC utilization by Sec. 904 category

FTC Limitation

Expense allocation - critical in determining the FTC limit for each basket. Generally, Pre-OB3, the following allocation methods are used to allocate certain types of deductions for 904 purposes:

- Interest: Apportion based on tax book value of assets
- Stewardship: Allocated and apportion based on relative value of stock in subsidiaries and tax basis in foreign branches
- R&E: Exclusive geographic allocation, then apportion based on gross receipts
- SG&A (Other Deductions): generally allocated based on reasonable allocation and apportionment methods

Section 904(d) Ratios: ratio of foreign source taxable income by basket relative to worldwide taxable income

FTC Limit (per basket) = US Tax Liability x Foreign-Source Taxable Income (per basket) / Worldwide Taxable Income

FTC Limitation - Example

Description	Total	US	General	Passive	GILTI	Branch
Gross Income	800,000	300,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(37,500)	(25,000)	(12,500)	(18,750)	(6,250)
R&D	(148,000)	(108,154)	(22,769)	(11,385)	-	(5,692)
Stewardship	(20,000)	(8,400)	(4,400)	(2,800)	(3,600)	(800)
Sec. 250 Deduction	(75,000)	-	-	-	(75,000)	-
Taxable Income	**457,000**	**145,946**	**147,831**	**73,315**	**52,650**	**37,258**

Description	Total	General	Passive	GILTI	Branch
Foreign Taxes Paid	166,000	60,000	20,000	45,000 x 80% = 36,000	50,000
904 Limit	65,321	31,044	15,396	11,057	7,824
FTC Utilization	**65,321**	**31,044**	**15,396**	**11,057**	**7,824**
FTC CF	**75,735**	**28,956**	**4,604**	**-**	**42,176**

US Tax liability: $457,000 x 21% = $95,970

904 Limitation by basket:

- General: 95,970 x 147,831/457,000 = 31,044
- Passive: 95,970 x 73,315/457,000 = 15,396
- GILTI: 95,970 x 52,650/457,000 = 11,057
- Branch: 95,970 x 37,258/457,000 = 7,824

- US Tax liability: 95,970
- FTC Utilized: (65,321)
- Residual US Tax: 30,649

FTC Limitation – Impact of SLL, OFL, ODL

Section 904 contains special provisions for “loss accounts” that required to be tracked to prevent taxpayers from using losses from one basket to shelter US income then later using foreign income to claim excess FTCs.

- **Separate Loss Limitation (SLL):** Occurs when a loss in a foreign basket reduces income in other foreign basket category.
  - can inflate FTC capacity in another basket - future income in that basket must be recaptured (recharacterized as income in offsetted baskets) until the SLL account is exhausted.
- **Overall Foreign Loss (OFL):** After SLL allocation, occurs when foreign source deductions exceed foreign source gross income.
  - This excess foreign loss reduces US source taxable income, lowering the FTC limit in such year. Future foreign-source income must be recaptured and recharacterized as US source income until the OFL account is exhausted.
- **Overall Domestic Loss (ODL):** occurs when US source losses exceed US source income in a year.
  - Excess US losses must reduce foreign source taxable income which can artificially increase the FTC limitation. Future US source income must be recaptured and recharacterized as foreign source until the ODL account is exhausted.

- **Ordering Rules for applying the SLL, OFL, and ODL – Reg. 1.904(g)-3**

FTC Limitation – SLL, ODL, OFL Simplified Ordering Rules

1. Allocate Net Operating Loss (NOL) and Net Capital Loss Carryovers
2. Apply Section 904(b) (i.e. Sec. 245A) Adjustments
3. Allocate SLL
4. Allocate OFL
5. Allocate ODL
6. Recapture OFL accounts
7. Recapture SLL Accounts
8. Recapture ODL Accounts

FTC Limitation – ODL Example

Description	Total	US	General	Passive	GILTI	Branch
Gross Income	800,000	300,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(37,500)	(25,000)	(12,500)	(18,750)	(6,250)
R&D	(148,000)	(108,154)	(22,769)	(11,385)	-	(5,692)
Stewardship	(20,000)	(8,400)	(4,400)	(2,800)	(3,600)	(800)
Sec. 250 Deduction	(75,000)	-	-	-	(75,000)	-
Taxable Income	457,000	145,946	147,831	73,315	52,650	37,258
ODL Recapture	-	(100,000)	40,000	20,000	30,000	10,000
Taxable Income (After Recapture)	**457,000**	**45,946**	**187,831**	**93,315**	**82,650**	**47,258**

Description	Total	General	Passive	GILTI	Branch
Foreign Taxes Paid	166,000	60,000	20,000	45,000 x 80% = 36,000	50,000
904 Limit	86,321	39,444	19,596	17,357	9,924
FTC Utilization	**86,321**	**39,444**	**19,596**	**17,357**	**9,924**
FTC CF	**61,035**	**20,556**	**404**	**-**	**40,076**

904 Limitation by basket BEFORE ODL:

General: 95,970 x 147,831/457,000 = 31,044
Passive: 95,970 x 73,315/457,000 = 15,396
GILTI: 95,970 x 52,650/457,000 = 11,057
Branch: 95,970 x 37,258/457,000 = 7,824

904 Limitation by basket AFTER ODL:

General: 95,970 x 187,831/457,000 = 39,444
Passive: 95,970 x 93,315/475,000 = 19,596
GILTI: 95,970 x 82,650/475,000 = 17,357
Branch: 95,970 x 47,258/475,000 = 9,924

Residual US Tax BEFORE ODL
US Tax liability: 95,970
FTC Utilized: (65,321)
Residual US Tax: 30,649

Residual US Tax AFTER ODL
US Tax liability: 95,970
FTC Utilized: (86,321)
Residual US Tax: 9,649

02

OB3 Reforms to the FTC Regime

I. Foreign Taxes Paid

II. Expense Allocation to NCTI

III. Branch Sourcing Rule

Foreign Taxes Paid – Changes To NCTI FTC Haircut

1. **Section 960(d) FTC for NCTI haircut increased from 80% to 90% of foreign taxes paid**
   - The TCJA provided a 20% haircut to all tested income taxes generated through the GILTI computation under Section 960(d), meaning taxpayers are only able to claim an FTC equal to 80% of the foreign income taxes paid associated with tested income.
   - OB3 would modify this 20% haircut and effectively allow for 90% of foreign income taxes paid pursuant to the NCTI (former GILTI) regime to be subject to FTCs (i.e. 10% haircut applied).

- **Effective for tax years beginning after December 31, 2025**

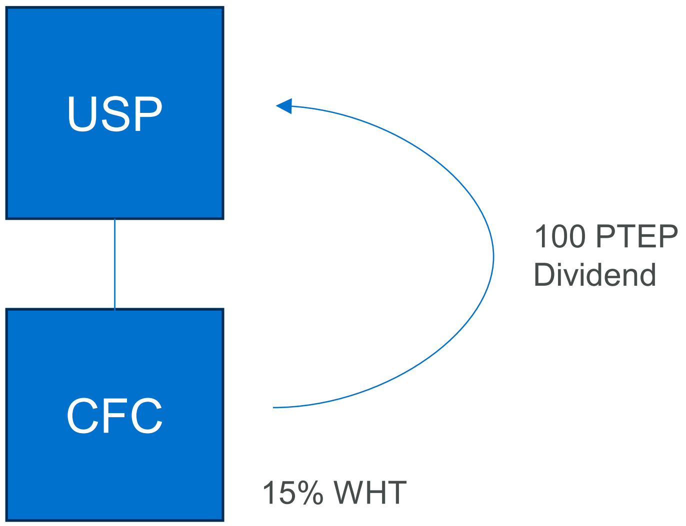
- **Implications:**
  - Increases eligible FTC in the NCTI Section 904 category basket for taxpayers owning CFCs
  - Mitigates the effect of lost NCTI FTCs following application of the FTC limitation
  - May complicate annual decision for electing high tax exclusion for NCTI vs. claiming higher NCTI FTCs

FTC Changes – Haircut to PTEP WHT for NCTI

2. **Foreign tax credit is disallowed for 10% of any foreign income taxes paid or accrued (or deemed paid) with respect to E&P distributions previously taxed as GILTI or NCTI.**

   - The TCJA does not provide a 20% haircut to foreign tax credits relating to PTEP in the GILTI category.
   - Includes a rule that applies the 10% haircut above to any FTCs attributable to previously taxed earnings and profits (**PTEP**) distributions to align with the NCTI FTC regime.

- **Effective for PTEP distributions after June 28, 2025**
- **Implications:**
  - Eliminates loop-hole with respect to PTEP WHT FTCs relating to PTEP distributions under the TCJA



Under Section 959, the $100 dividend is excluded from US income.

Prior to OB3, the $15 of WHT was potentially creditable, subject to 904 limitations.

With OB3, 10% of the tax is disallowed as creditable, leaving only $13.50 of the WHT as potentially creditable, subject to further limitations.

FTC Changes – NCTI Expense Allocation

3. **Modification of expenses allocated to the NCTI Sec. 904 category.**

- Modifies the expense allocation and apportionment rules associated with the NCTI limitation category (f/k/a GILTI) by only requiring the following expenses be allocated to the NCTI basket:
  - (a) an allocation of the Section 250 deduction relating to NCTI and
  - (b) an allocation of any directly allocated expenses.
- Apportioned Expense Reclass Rule: Any expenses that would be apportioned because they do not definitely relate to NCTI, would effectively be allocated and apportioned to the US source residual basket for FTC limitation purposes.
- **Effective for tax years beginning after December 31, 2025**
- **Implications:**
- Higher ability to utilize FTCs in NCTI basket
- Higher potential for ODL creation due to other OB3 changes
- BEAT considerations

Tax Cuts & Jobs Act

1. Section 250 Deduction - NCTI
2. Interest Expense
3. Directly Allocated Stewardship Expense
4. Apportionable Stewardship Expense
5. Directly Allocated Expenses
6. Apportionable Expenses

One Big, Beautiful Bill

1. Section 250 Deduction - NCTI
2. Directly Allocated Stewardship Expense
3. Directly Allocated Expenses

FTC Changes – New Inventory Sourcing Rule

4. **Modifications to sourcing rules for US produced inventory sold to include a capped amount of foreign source income reflected in the FTC limitation computation.**

- OB3 includes a new sourcing rule for FTC limitation purposes that effectively caps the amount of foreign source income from the sale of inventory that is produced by the US to no more than 50% of the total taxable income from the sale or disposition of inventory property.
- Applies only for Section 904 FTC limitation purposes
- the general rule requiring that inventory sales be sourced based on where the production activities of the inventory occurred is to be respected as noted in Section 863(b) for all other purposes.

- **Effective for tax years beginning after December 31, 2025**

- **Implications:**
- Mitigates some historical negative implications with the foreign branch basket
- Higher ability to claim foreign branch / general basket FTCs
- BEAT considerations

03

Modeling the Impact of Changes to Domestic Provisions

I. Higher NCTI FTCs Example

II. Big Three Overview – OB3

III. ODL Issue Example

FTC Changes – NCTI Expense Allocation Example

Description	Total	US	General	Passive	GILTI	Branch
Gross Income	800,000	300,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(37,500)	(25,000)	(12,500)	(18,750)	(6,250)
R&D	(148,000)	(108,154)	(22,769)	(11,385)	-	(5,692)
Stewardship	(20,000)	(8,400)	(4,400)	(2,800)	(3,600)	(800)
Sec. 250 Deduction	(75,000)	-	-	-	(75,000)	-
Taxable Income	**457,000**	**145,946**	**147,831**	**73,315**	**52,650**	**37,258**

US Tax liability – Pre OB3: $457,000 x 21% = $95,970

904 Limitation by basket Pre OB3:

- **General: 95,970 x 147,831/457,000 = 31,044**
- **Passive: 95,970 x 73,315/457,000 = 15,396**
- **GILTI: 95,970 x 52,650/457,000 = 11,057**
- **Branch: 95,970 x 37,258/457,000 = 7,824**

Residual US Tax Pre OB3:
US Tax liability: 95,970
FTC Utilized: (65,321)
Residual US Tax: 30,649

Description	Total	US	General	Passive	NCTI	Branch
Gross Income	800,000	300,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(56,250)	(25,000)	(12,500)	-	(6,250)
R&D	(148,000)	(108,154)	(22,769)	(11,385)	-	(5,692)
Stewardship	(20,000)	(12,000)	(4,400)	(2,800)	-	(800)
Sec. 250 Deduction	(60,000)	-	-	-	(60,000)	-
Taxable Income	**472,000**	**123,596**	**147,831**	**73,315**	**90,000**	**37,258**

US Tax liability Post OB3: $472,000 x 21% = $99,120

904 Limitation by basket Post OB3:

- **General: 99,120 x 147,831/472,000 = 31,044**
- **Passive: 99,120 x 73,315/472,000 = 15,396**
- **NCTI: 99,120 x 90,000/472,000 = 18,900**
- **Branch: 99,120 x 37,258/472,000 = 7,824**

Residual US Tax Post OB3:
US Tax liability: 99,120
FTC Utilized: (73,164)
Residual US Tax: 25,955

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Big 3 Overview – OB3

1. **Bonus Depreciation (168(k)):** OB3 permanently restores 100% bonus depreciation for qualified property place in service after 2024.

    Assets acquired after January 20, 2025 are eligible for 100% bonus

2. **R&E (174):** OB3 restores immediate expensing of R&D costs beginning in 2025. Taxpayers may elect to accelerate deductions for costs capitalized in 2022-2024 (either all in 2025 or a split between 2025/2026). Foreign R&D is still subject to capitalization and amortization.

    Effective for tax years beginning after December 31, 2024. Taxpayers may elect to deduct unamortized balances that originated in tax years 2022-2024 in 2025.

3. **Business Interest Limitation (163(j)): OB3 permanently restores the deduction for depreciation and amortization in computing ATI for purposes of the interest expense limitation.**

    Effective for tax years beginning after December 31, 2024

FTC Changes – Interaction of 174A with FTCs Example

Description	5 Year Amortize	Deduct All Historical R&D in 2025 / Go Forward
2022	20,000	-
2023	22,000	-
2024	40,000	-
2025	40,000	-
2026	26,000	260,000
Total R&D Deduction	**148,000**	**260,000**

FTC Changes – 5 Year Capitalization / Post OB3

Description	Total	US	General	Passive	NCTI	Branch
Gross Income	700,000	200,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(50,000)	(28,571)	(14,286)	-	(7,143)
R&D	(148,000)	(100,909)	(26,909)	(13,455)	-	(6,727)
Stewardship	(20,000)	(12,000)	(4,400)	(2,800)	-	(800)
Sec. 250 Deduction	(60,000)	-	-	-	(60,000)	-
Taxable Income	**372,000**	**37,091**	**140,119**	**69,460**	**90,000**	**35,330**

US Tax liability Post OB3: $372,000 x 21% = $78,120

904 Limitation by basket:
- **General: 78,120 x 140,119/372,000 = 29,425**
- **Passive: 78,120 x 69,460/372,000 = 14,587**
- **NCTI: 78,120 x 90,000/372,000 = 18,900**
- **Branch: 78,120 x 35,330/372,000 = 7,419**

Description	Total	General	Passive	NCTI	Branch
Foreign Taxes Paid	170,500	60,000	20,000	45,000 x 90% = 40,500	50,000
904 Limit	70,331	29,425	14,587	18,900	7,419
FTC Utilization	**70,331**	**29,425**	**14,587**	**18,900**	**7,419**
FTC CF	**78,569**	**30,575**	**5,413**	**-**	**42,581**

Residual US Tax:
US Tax liability: 78,120
FTC Utilized: (70,331)
Residual US Tax: 7,789

FTC Changes – Interaction of 174A with FTCs Example

Description	5 Year Amortize	Deduct All Historical R&D in 2025 / Go Forward
2022	20,000	-
2023	22,000	-
2024	40,000	-
2025	40,000	-
2026	26,000	260,000
Total R&D Deduction	**148,000**	**260,000**

FTC Changes – Full Deduction in 2025 and Forward / Post OB3

Description	Total	US	General	Passive	NCTI	Branch
Gross Income	700,000	200,000	200,000	100,000	150,000	50,000
Interest	(100,000)	(50,000)	(28,571)	(14,286)	-	(7,143)
R&D	(260,000)	(177,273)	(47,273)	(23,636)	-	(11,818)
Stewardship	(20,000)	(12,000)	(4,400)	(2,800)	-	(800)
Sec. 250 Deduction	(60,000)	-	-	-	(60,000)	-
Taxable Income	**260,000**	**(39,273)**	**119,756**	**59,278**	**90,000**	**30,239**
ODL Allocation	(0)	39,273	(15,715)	(7,779)	(11,810)	(3,968)
Taxable Income (After Recapture)	**260,000**	**-**	**104,041**	**51,499**	**78,190**	**26,271**

US Tax liability Post OB3: $260,000 x 21% = $54,600

904 Limitation by basket:
- **General: 54,660 x 104,041/260,000 = 21,849**
- **Passive: 54,660 x 51,499/260,000 = 10,815**
- **NCTI: 54,660 x 78,190/260,000 = 16,420**
- **Branch: 54,660 x 26,271/260,000 = 5,517**

Description	Total	General	Passive	NCTI	Branch
Foreign Taxes Paid	170,500	60,000	20,000	45,000 x 90% = 40,500	50,000
904 Limit	54,600	21,849	10,815	16,420	5,517
FTC Utilization	**54,600**	**21,849**	**10,815**	**16,420**	**5,517**
FTC CF	**91,820**	**38,151**	**9,185**	**-**	**44,483**

Residual US Tax:
US Tax liability: 54,600
FTC Utilized: (54,600)
Residual US Tax: 0

Key Takeaways

1. The Big Three are the drivers
2. Higher NCTI FTCs starting in 2026
3. Greater Potential to Create ODLs
4. Ability to increase foreign source income in the foreign branch basket starting in 2026
5. Higher onus on expense allocation and apportionment methodologies
6. Must always consider BEAT
7. Modeling is more important then ever

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