

# **OFFSHORE INVESTMENT**

## **U.S. – INTERNATIONAL TAX PLANNING AN ASIAN PERSPECTIVE**

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SHANGHAI**

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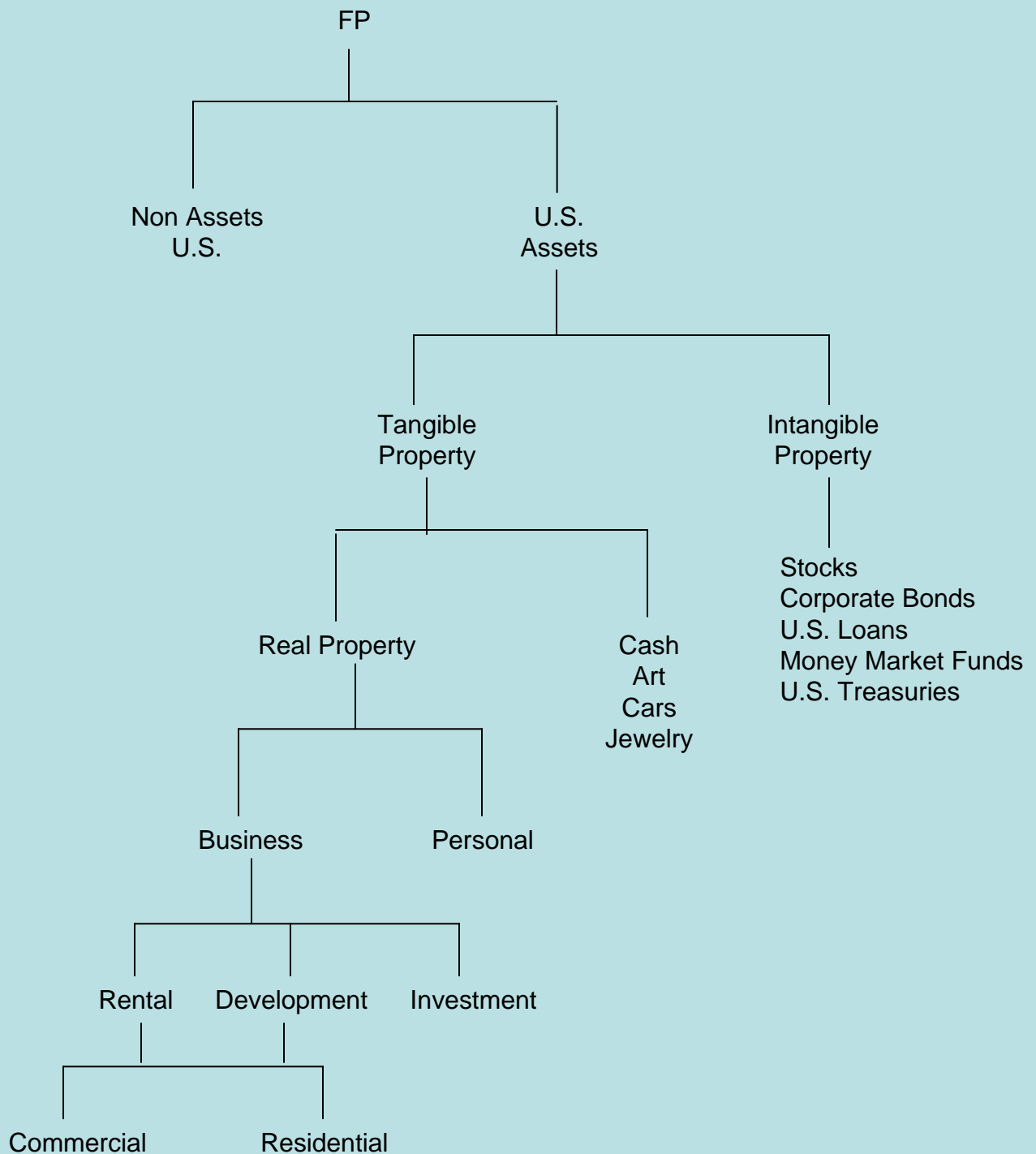
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# Ownership of U.S. Assets



## Income Tax Rates

<u>Individual Income Tax Rates</u>	<u>Federal</u>	<u>Average State</u>	<u>Total</u>
Ordinary Rates [single person]	35% @ \$186,825	6%	41%
Capital Gains	Maximum 15%	6%	21%

### U.S. Corporations

Ordinary Rates	34%	6%	40%
Capital Gains	34%	6%	40%
Dividends Paid to FP	30% or lower treaty rate	N/A	30%

### Foreign Corporations

Income Tax	34%	6%	40%
Capital Gains	34%	6%	40%
Dividends Paid to FP	N/A	N/A	N/A
Branch Profits Tax	30% or lower treaty rate	N/A	30%



## Example of Individual vs. Corporate Tax Rates

### Compare Sale of Investment Property

Buy Property	100
Sell Property	<u>200</u>
Gain	<u><u>100</u></u>

A) <u>Individual Tax</u>	<u>Federal</u>	<u>State</u>	<u>Total</u>
Gain of \$100	15%	6%	<u>21%</u>
 B) <u>Corporation Tax</u>			
(1) Income Tax			
Gain of \$100	34%	6%	40%
 (2) <u>Tax on Dividend Distribution</u>			
U.S. Corp. to foreign owner	30%	-0-	
(100 – 40%)	<u>x 60%</u>		
	18%		<u>18%</u>
Total Tax	(40% + 18%)	=	<u>58%</u>



## Assets Subject to U.S. Gift & Estate Tax

Assets subject to tax:

Estate Tax: Property “situated in the U.S.” [Section 2103]

Gift Tax: - Property “situated in the U.S.” [Section 2511]

- Intangible property is excluded [Section 2501 (a) (2)]

	<u>Tangible (T) or Intangible (I)</u>	<u>U.S. Gift Tax</u>	<u>U.S Estate Tax</u>
Cash in U.S. bank	T	Y	N <sup>(1)</sup>
U.S. Money Market Fund	I	N	Y
U.S. LLC	I	N	- <sup>(2)</sup>
U.S. Stocks	I	N	Y
U.S. Bonds	I	N	Y
U.S. Real Property	T	Y	Y
Art	T	Y	Y <sup>(3)</sup>
Autos	T	Y	Y
Jewelry	T	Y	Y

(1) Special exception for cash in U.S. banks

(2) Facts and circumstances

(3) Exception for art in the U.S. on display in U.S. exhibition



# U.S. Gift & Estate Tax Rates & Exemptions

<b>Estate Tax Rates Table</b>		
Subject to Exemptions and Maximum Tax Rates Table		
<b>Estate Amount Exceeding:</b>	<b>Up to:</b>	<b>Is taxed at a rate of:</b>
\$1,000,000	\$1,250,000	41%
\$1,250,000	\$1,500,000	43%
\$1,500,000	\$2,000,000	45%
\$2,000,000	\$2,500,000	49%
\$2,500,000	\$3,000,000	50%
\$3,000,000	\$10,000,000	55%
\$10,000,000+	\$17,184,000	60%
\$17,184,000+		55%

<b>Exemptions and Maximum Tax Rates</b>		
<b>Year</b>	<b>Estate Tax Exemption</b>	<b>Highest Rate</b>
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2 million	46%
2007	\$2 million	45%
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	N/A (taxes eliminated)	0%
2011	\$1 million	60%

Note: Uncertainty regarding 2010 Estate Tax

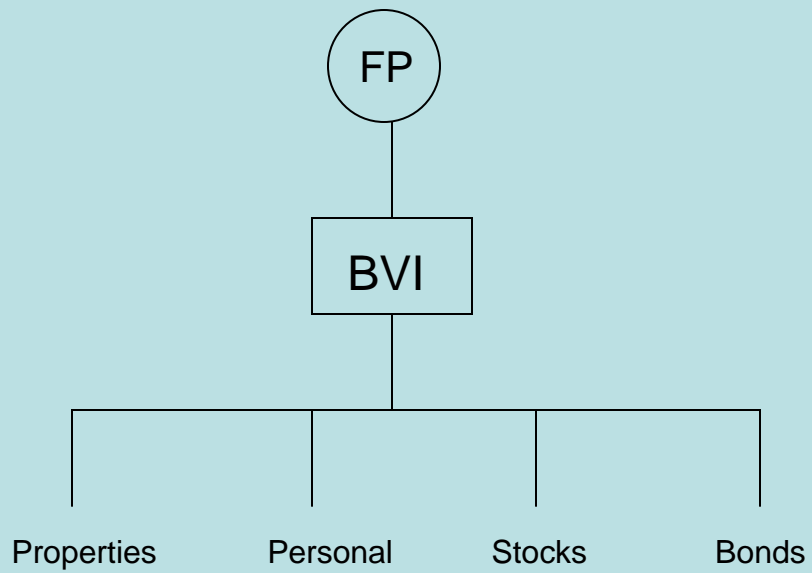
### Exemptions:

- Gift Tax - \$13,000 per year annual exemption
- Estate Tax - \$60,000 exclusion



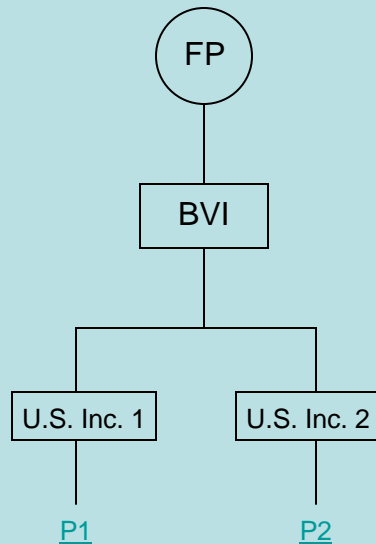
# Typical “One-Stop Shop” Solution

## Typical Structure

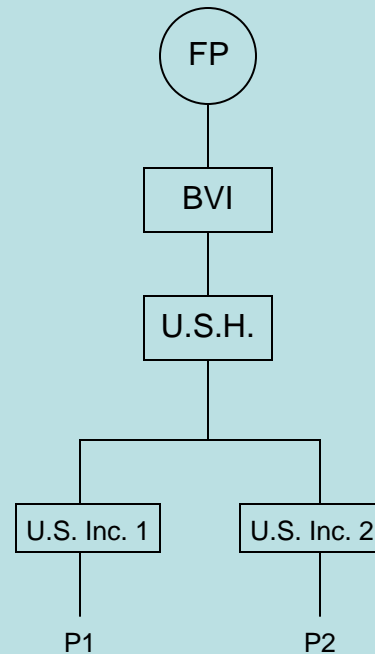


# Foreign Investment in Real Property Tax Act [1980] “FIRPTA”

Alternative 1



Alternative 2

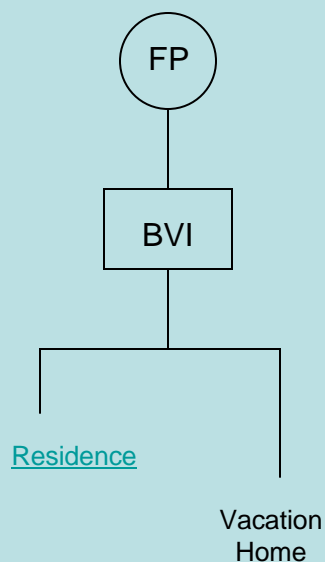


## Foreign Corporation Structure

- Estate tax eliminated by foreign corporation
- Corporate tax rates on income and on gains
- Dividends paid by foreign corporation = 30% [lower treaty rate] withholding tax
- Confidentiality for ultimate foreign owner
- Sale of all U.S. property and liquidation of U.S. corporation [tax-free] avoids dividend withholding tax
  - For this reason, we usually see each U.S. property held in a separate U.S. Company [Alternative 1]
  - If U.S. holding company is used, the gains and losses are combined [Alternative 2]
    - Downside is the loss of tax-free liquidation

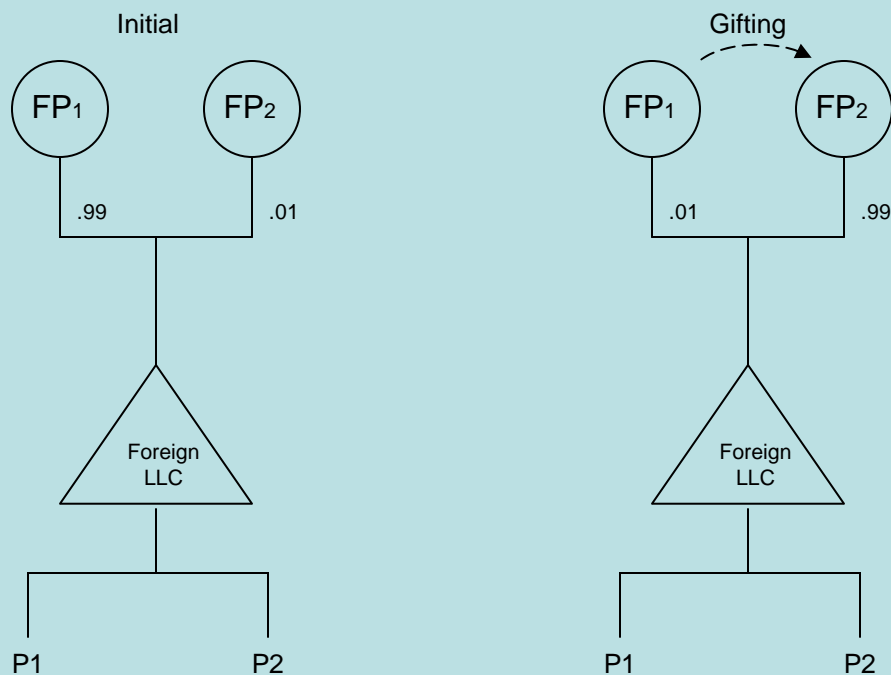


## Residence Property Ownership



- Estate Tax
  - Corporate structure will generally avoid U.S. estate tax
  - Corporate sales are subject to U.S. corporate tax – 40%
- Risks
  - Section 2036 – life interest in a property included in a U.S. estate
  - Without rental activity, has FP retained property?
- Practical Answers
  - Sales by BVI companies rarely audited
  - Charge a nominal rent
  - If more than a nominal rent, then tax returns will be due or rental payments are subject to 30% flat rate of tax

# Ownership Through Foreign Partnerships



## Partnership Benefits compared to ownership through foreign corporation

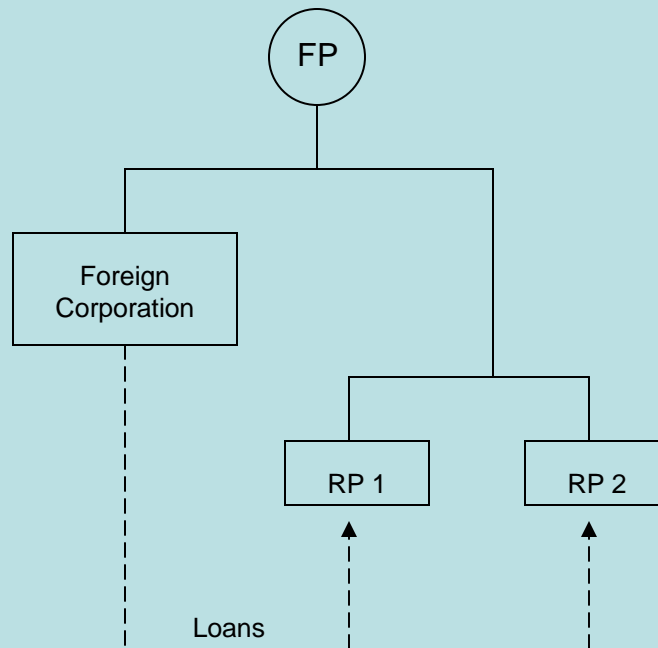
- Single Level of Income Tax
  - FP pays tax
  - FP qualifies for 15% capital gain rates
  - FP files annual returns to report U.S. income
- Partnership Interest = Intangible Property
- Partnership Interest [U.S. or foreign] is not subject to U.S. gift tax

## Risk

- FP1 dies before transfer of ownership
  - Unresolved – for estate tax reporting, is each U.S. asset:
    - (a) an interest in a foreign intangible asset, or
    - (b) an interest in real property?
- Estate tax rules are unclear
- Practical approach



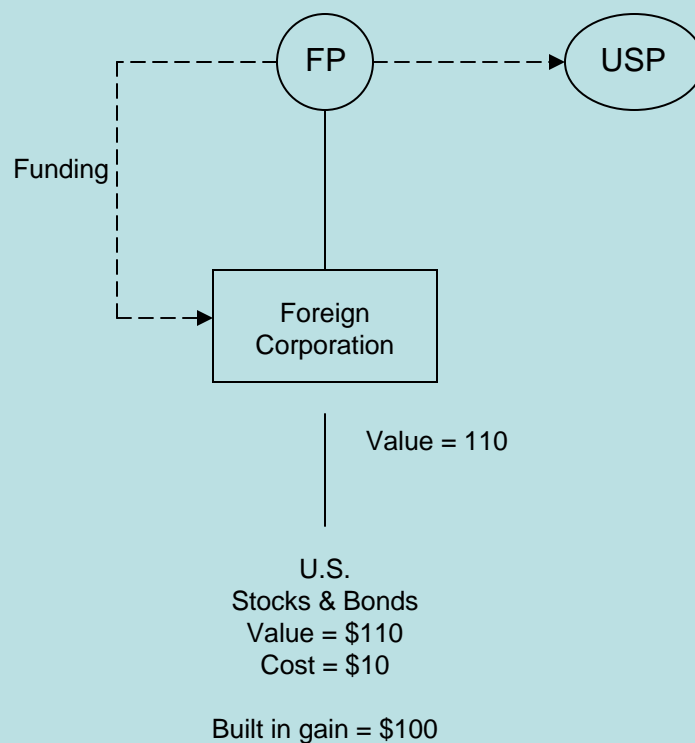
## Use of Debt to Reduce U.S. Tax Exposure



- Debt will reduce the net fair market value of the U.S. property subject to estate tax
- Excessive debt to equity ratio of more than a 3:1 creates limitations:
  - Interest deductions are subject to limitations
  - Related party debt exceeding 3:1 ratio may be disallowed
  - Arms length terms and documentation required
    - interest and principal payments should be made
    - loan should be recorded as a lien against property
- Interest may be subject to a 30% [or lower treaty rate] withholding tax
- Practical limitations often limit the use of this structure



## Wealth Transfers to U.S. Persons

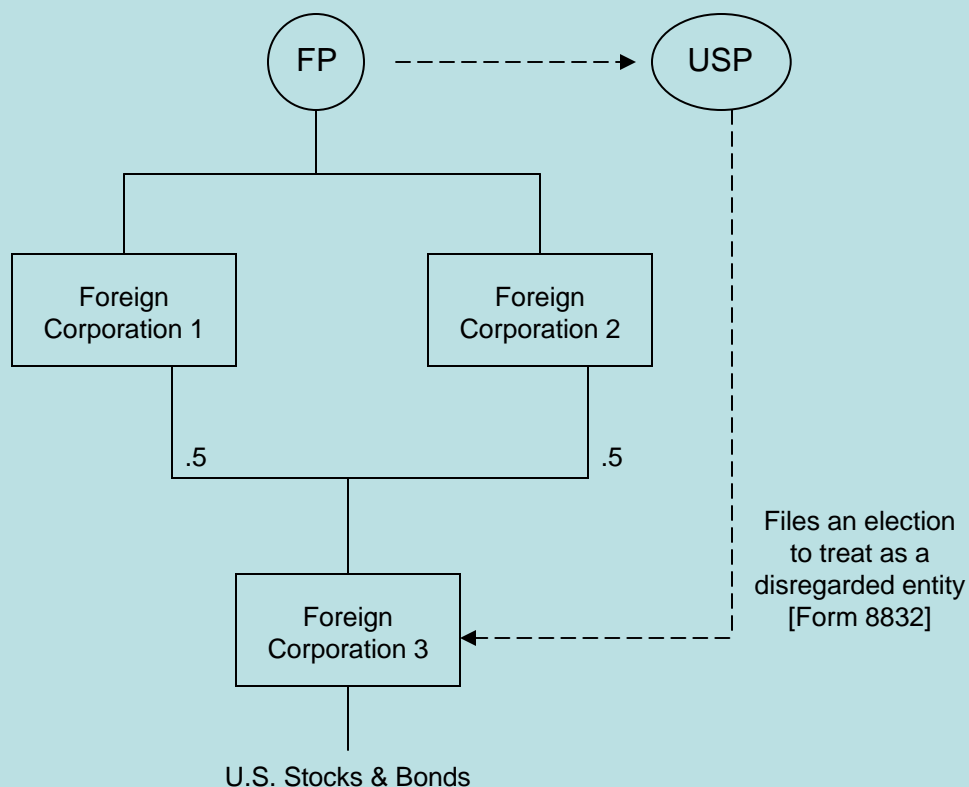


### Problem with typical ownership

At date of death, USP inherits foreign corporation:

- Basis of foreign corporation steps up to \$110 [Section 1014]
- Tax basis of assets inside corporation do not step up
- Old basis carries over
- Liquidation of foreign corporation results in \$100 of dividend income to USP [Subpart F income under Section 954]
- Sale of assets by the foreign corporation results in deemed dividend of \$100 to USP [Subpart F income under Section 954]

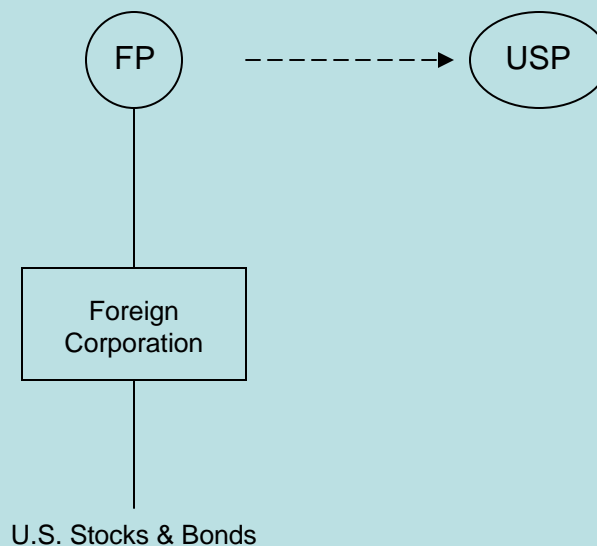
## Solution # 1: Using a “Check-the-Box” Election



At date of death,

- USP inherits two foreign corporations
- The shares in Foreign Corporations (1) and (2) step up to their fair market value at date of death of FP
- USP files an election with Form 8832 to treat Foreign Corporation 3 as a disregarded entity
  - The election causes Foreign Corporation 3 to be treated as being liquidated for U.S. tax purposes only
  - The liquidation causes the assets in Foreign Corporation 3 to step up to their fair market value as long as neither (1) nor (2) owns 80% or more of (3).
  - If the election is made within 75 days of date of death, then the liquidation of (3), for U.S. tax is treated as being effective prior to death of foreign owner
- USP can now liquidate (1) and (2) and will own all the U.S. stocks & bonds at fair market value without paying any income or estate tax
- Limitation: Strategy does not work with real property.

## Solution # 2: Thirty Day Liquidation



At date of death:

- USP inherits the foreign corporation with its basis stepped up to its fair market value
- Assets inside corporation will not step up
- USP now owns a “controlled foreign corporation” [Section 957]
- Sale of assets creates “Subpart F Income” = deemed divided to USP
- Exception: There is no Subpart F Income if the CFC exists for less than 30 days [Section 951]
  - Within 30 days of death, liquidate the foreign company
  - The gain from the liquidation of the CFC is no longer taxable to the USP since basis of FC stock = FMV of stock
  - Question: Can the documents and liquidation be accomplished within 30 days of the death of the foreign person?





Brian Rowbotham is a CPA with 33 years of experience advising businesses and individuals on complex domestic and international income and estate tax planning. He is the founding partner of Rowbotham & Company LLP which is almost exclusively dedicated to businesses and investors needing both domestic and international tax and accounting services.

His clients include private and public companies around the globe which consist of: U.S. and foreign institutional investors, multinational families and executives and non-U.S. investors doing business in the U.S.

Mr. Rowbotham has advised clients in major domestic and international litigation and has also served on the boards of both privately held and publicly traded companies. From 1992 to 2006, he directly supervised his firm's engagement by trustees in Europe to assist with the recoveries of funds from one of the largest frauds in U.K. history. Over the past 20 years, he has represented large European and Middle Eastern institutional investors and numerous Asian families investing in U.S. Real Estate transactions.

Mr. Rowbotham has been a frequent guest lecturer at the Haas School of Business, University of California Berkeley, and at the University of San Francisco. He taught graduate courses on corporate and partnership taxation at the University of California Extension. He has been a speaker for several U.S. and international tax planning organizations, including the ITPA and STEP, in Europe, Asia and the U.S. He presented in-house training lectures on investment structures for acquisitions of U.S. property at major European trust companies and banking institutions.

Mr. Rowbotham is a frequent commentator on international tax topics of interest. He submitted proposed legislation to the U.S. Treasury in the FIRPTA arena which resulted in changes to final regulations on withholding tax on foreign partnerships with investments in U.S. Real Property. This past year he issued several commentaries that were critical of IRS procedures and policies in the FBAR amnesty program.

He is member of the Tax Division of the AICPA and a past president of the San Francisco Tax Club. Mr. Rowbotham is a former featured columnist for Outlook, the official journal for the California Society of CPAs. He has been a contributor to the Journal of Accountancy and several international tax and investment journals. In 2005, he was profiled in the San Francisco Business Times as an entrepreneur of the accounting profession. In April 2009, his article "Doing Business in China" was featured on the cover of the California CPA Journal.

Mr. Rowbotham began his career in national accounting firms in San Francisco and London, specializing in international tax, before founding Rowbotham & Company in 1991. He was born in Buenos Aires with British citizenship, and became a naturalized U.S. citizen in 1969. He earned his bachelors degree and MBA, with honors, from the University of California, Berkeley.



Harriet Leung is a certified public accountant and an audit partner. She heads up the firm's Asian business practice engagements for private and public companies. She oversees activities related to the firm's membership of the American Institute of Certified Public Accountants (AICPA) and Public Company Accounting Oversight Board (PCAOB). These memberships allow the firm to service both private and publicly held companies.

Ms. Leung's client base includes companies in real estate (including domestic and foreign), international investments, science, distribution, high-tech and software.

Ms. Leung is active advising companies with M&A transactions and international clients in the financial due diligences, audit and business advisory areas. She has substantial experience servicing companies that were seeking listings on both foreign and U.S. stock exchange markets. She has represented and worked with companies in Asia completing reverse mergers into the U.S. public companies. Ms. Leung also has extensive experience working in restructuring international investment funds with operations in the U.S., but owned and controlled in Asia.

Ms. Leung earned a Bachelor of Science in Accounting with honors and a Master in Finance from Golden Gate University. She also received several scholarships and awards of distinction at Golden Gate University.

Ms. Leung is a member of several organizations including the San Francisco Chapter of the California Society of CPAs, the American Institute of Certified Public Accountants, the Monte Jade Science and Technology Association, the Hong Kong Association of Northern California, the Silicon Valley Chinese Wireless Technology Association and the Hong Kong General Chamber of Commerce. Ms. Leung also serves on the advisory committee and leadership development committee for the non-profit Tax-Aid program that provides tax services to low income families in the San Francisco Bay Area.

Ms. Leung is fluent in both Cantonese and Mandarin.