

International Tax

Inbound Tax Planning

December 7, 2010

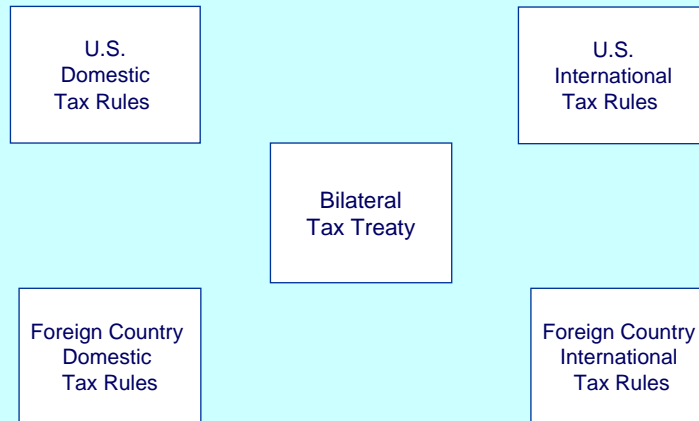
CalCPA Education Foundation

Peter Trieu, Esq., LLM

Rowbotham & Company LLP
Certified Public Accountants

(415) 433-1177
ptrieu@rowbotham.com

Interacting Tax Rules



Frequent Planning Opportunities

Situations frequently requiring international tax planning:

- Timing of income recognition:
 - Pre-arrival planning
 - Pre-departure planning
- Managing U.S. tax residency

U.S. Taxation of Nonresident Foreign Nationals

- (1) Taxed
 - U.S. Source Income - 30% tax rate ⁽¹⁾
 - Interest Dividends - Ordinary tax rates
 - U.S. Trade or Business effectively connected with a U.S. trade or business ⁽²⁾
- (2) Not Taxed
 - Capital gains (Unless in U.S. over 183 days) ⁽³⁾
 - Interest if defined as "Portfolio Income" ⁽⁴⁾
 - Exempt individuals (government, trainees, students, athletes) ⁽⁵⁾
- (3) Treaty Override of U.S. Rules
 - e.g. U.K. – U.S. Income Tax Treaty reduces the 30% tax rate to zero on royalties (Article 12)
 - Japan – U.S. Income Tax Treaty reduces the tax rate to 10% (Article 12)

U.S. Taxation of Residents

Residents taxed on worldwide income

There are three principal ways to become a U.S. tax resident:

- Substantial presence test (formula) ⁽⁶⁾
- Lawful permanent resident (Green Card)
- Citizenship

Elections:

- If present in U.S. for 31 days and 75% of subsequent days in election year ⁽⁷⁾
- Married to a resident or citizen and electing to file a joint return ⁽⁸⁾
- In general: Visa generally not a factor

Substantial Presence Test

The substantial presence test met if taxpayer is:

- Present in the U.S. at least 31 days in the current year; and
- Present in the U.S. for 183 days according to a formula:

Year	days	multiplier	
2010	120	1	120
2009	120	1/3	40
2008	120	1/6	<u>20</u> 180

- Exceptions: (1) Taxpayer has a closer connection to a foreign country ⁽⁹⁾
(2) If current year's days exceed 182: only Treaty tie breaker test will override residence

Income Tax Treaty

Lawful Permanent Resident: Treaty tie-breaker test may override

Article 4: Tie Breaker Test – South Africa – U.S. Income Tax Treaty

- If you are defined to be a resident of both countries, the Treaty will determine whether you are a resident of South Africa or the United States
 - Permanent home or abode
 - Center of vital interests
 - Habitual abode
 - Nationality
 - Competent authorities
- To qualify, the foreign national must be subject to tax in other country.

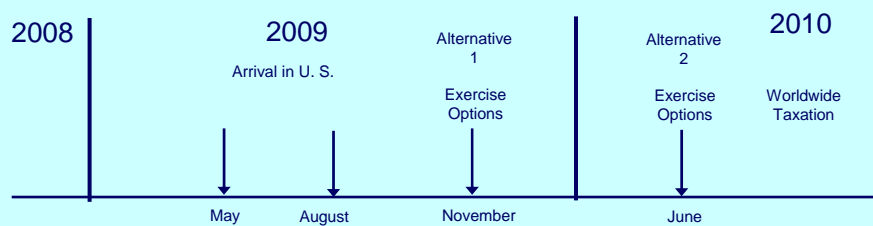
Pre-arrival Planning

Pre-arrival planning can include:

- Realize income prior to becoming a U.S. tax resident
- Undertake transactions to step up basis in assets
- Pre-arrival sale of assets
- Pre-arrival foreign trust planning

Exercising Stock Options: Timing is Everything

Options awarded in 2007



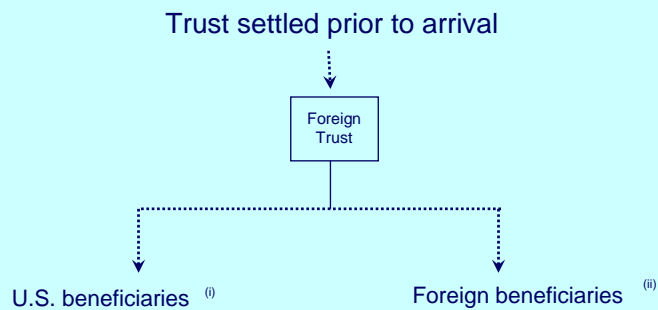
Early exercise avoids taxation of "in the money options"

Pre-Arrival Planning Stepping up Tax Basis



* Foreign Transactions Recognized
Biddle v. Commr, 302 U.S. 573, Supreme Court held that U.S. tax concepts control for foreign persons.

Pre-Arrival Formation of Trusts



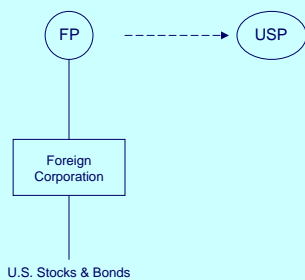
- (i) Income taxed to settlor if trust established within 5 years of establishing U.S. residence ⁽¹⁰⁾
- (ii) Income not taxed to any U.S. beneficiary

Pre-Arrival Planning Liquidating Controlled Foreign Corporation



- Consider liquidating prior to becoming a U.S. resident
 - Controlled Foreign Corporation rules will convert capital gain into ordinary income ⁽¹¹⁾
 - In general, holding assets in a controlled foreign corporation creates unnecessary tax complexity, increased taxes, and additional tax reporting

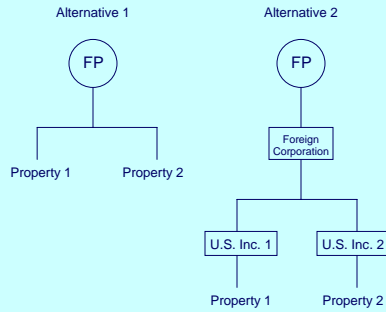
Avoiding Problems for U.S. Beneficiaries



At date of death:

- USP inherits the foreign corporation with a fair market value basis
- Assets inside corporation will not step up
- USP now owns a “controlled foreign corporation”
- Sale of assets creates “Subpart F Income” = deemed dividend to USP
- Exception: There is no Subpart F Income if the CFC exists for less than 30 days
 - Within 30 days of death, liquidate the foreign company
 - Gain from the liquidation of the CFC
 - Inside gain not taxed due to 30 day exception rule ⁽¹²⁾
 - Outside gain not taxed since basis in foreign corporation stock steps up

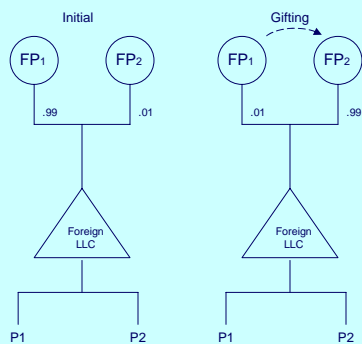
Foreign Investment in Real Property Tax Act [1980] "FIRPTA"



Foreign Corporation Structure

- Estate tax exposure in Alternative 1, NA in Alternative 2
- Single level of tax vs. Corporate double tax on operating income and on gains
- Individual tax filings vs. confidentiality for foreign owner with corporate structure

Ownership through Foreign Partnership



Foreign Partnership Benefits compared to ownership through foreign corporation

- Single Level of Income Tax
 - Gains taxed at 15%
- 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, whether interest in foreign partnership is:
 - (a) an interest in a foreign situs asset, or
 - (b) an interest in U.S. real property?
- Estate tax rules are unclear

References

- (1) Code § 871 (a)
- (2) Code § 871 (b)
- (3) Code § 871 (a)(2)
- (4) Code § 871 (h)
- (5) Code § 871 (c)
- (6) Code § 7701 (b)(3)
- (7) Code § 7701 (b)(4)
- (8) Code § 6013
- (9) Regs. § 301.7701 (b)(2)(a)
- (10) Code § 679 (b) and (c)(3)
- (11) Code § 951
- (12) Code 951 (a)(1)

Rowbotham & Company LLP



Peter Trieu is a Tax Director at Rowbotham & Company. His practice focuses on advising clients regarding domestic and international tax planning and compliance. He also assists clients with their estate plans.

His clients include private and public companies around the globe, U.S. and foreign institutional investors, multinational families and executives and non-U.S. investors doing business in the U.S. Mr. Trieu co-authored “Doing Business in India” published in the May/June 2009 issue of CalCPA magazine.

Additional Firm Resources

Tax Planning and Consulting - Domestic & International: Brian Rowbotham br@rowbotham.com

Asia Practice, Corporate Consulting : Harriet Leung hleung@rowbotham.com

Audit & SEC Practice: Mark Kelly mkelly@rowbotham.com

Corporate Tax: Marcia De Forest mdeforest@rowbotham.com

Tax Compliance - Domestic & International: Cindy Hsieh chsieh@rowbotham.com

Website: www.rowbotham.com

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