

OFFSHORE INVESTMENT

U.S. – INTERNATIONAL TAX PLANNING AN ASIAN PERSPECTIVE

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SHANGHAI**

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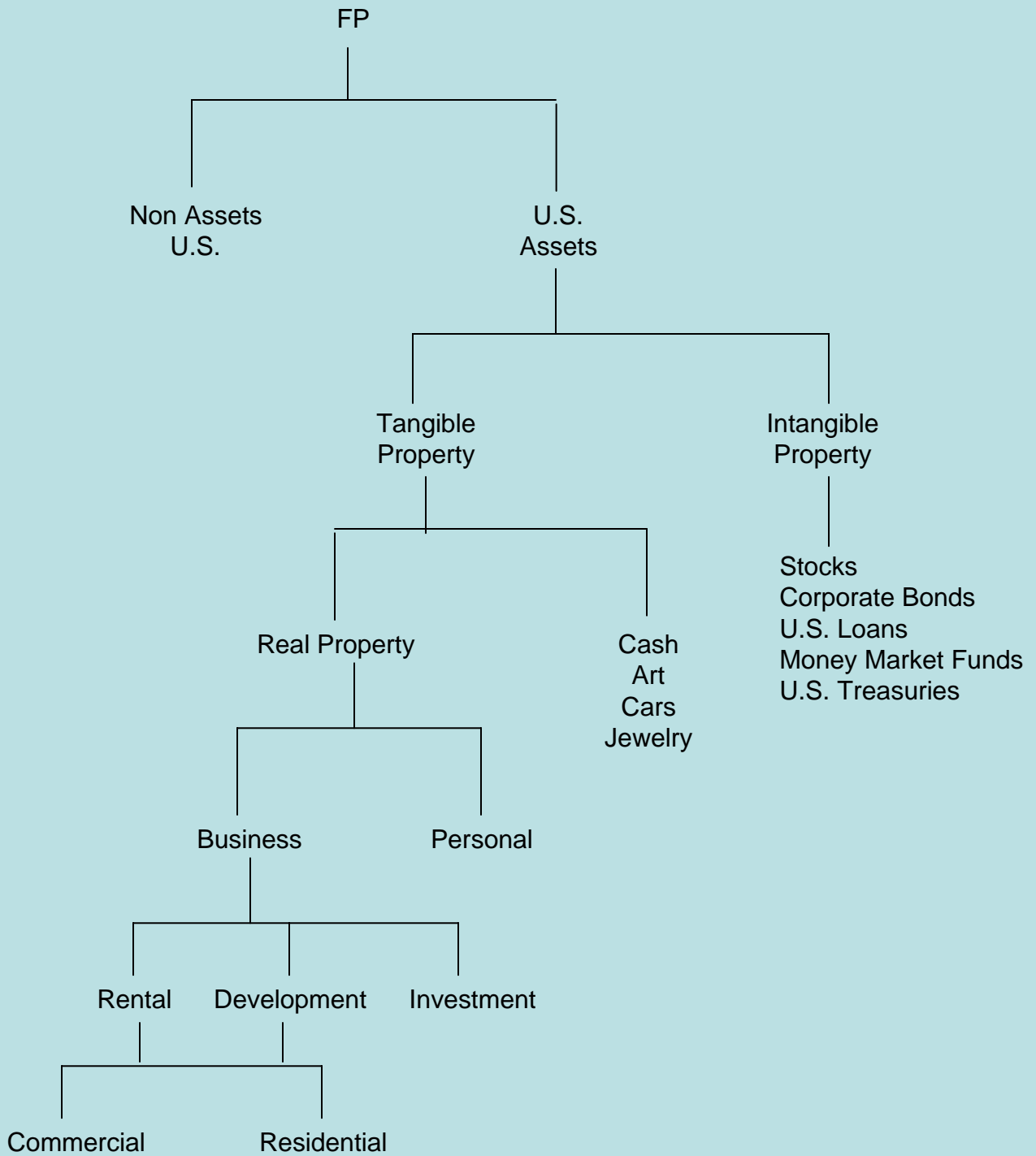
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Ownership of U.S. Assets



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 ⁽¹⁾
U.S. Money Market Fund	I	N	Y
U.S. LLC	I	N	- ⁽²⁾
U.S. Stocks	I	N	Y
U.S. Bonds	I	N	Y
U.S. Real Property	T	Y	Y
Art	T	Y	Y ⁽³⁾
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

Estate Tax Rates Table		
Subject to Exemptions and Maximum Tax Rates Table		
Estate Amount Exceeding:	Up to:	Is taxed at a rate of:
\$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%

Exemptions and Maximum Tax Rates		
Year	Estate Tax Exemption	Highest Rate
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

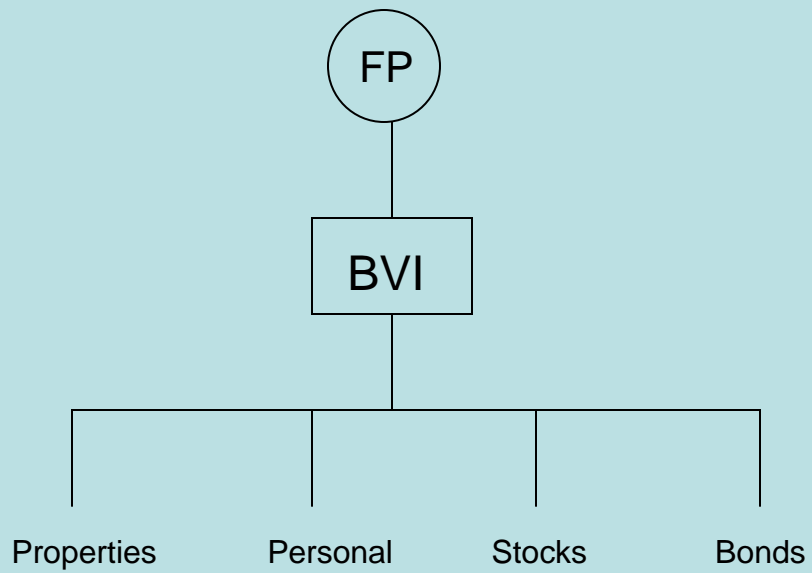
Exemptions:

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



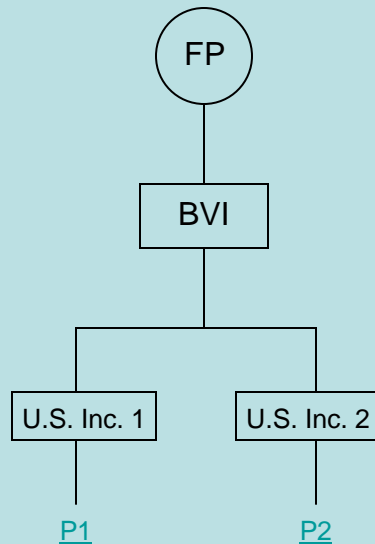
Typical “One-Stop Shop” Solution

Typical Structure

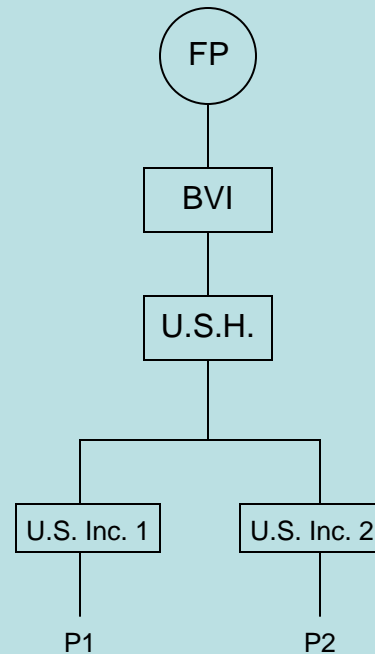


Foreign Investment in Real Property Tax Act [1980] “FIRPTA”

Alternative 1



Alternative 2

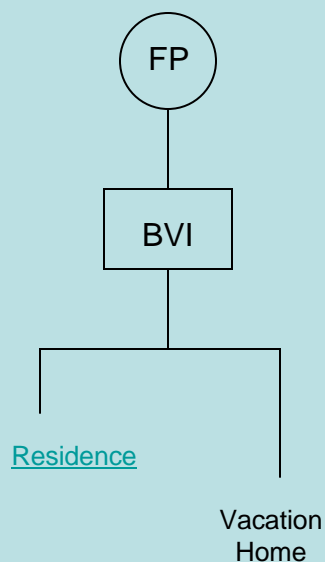


Foreign Corporation Structure

- 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

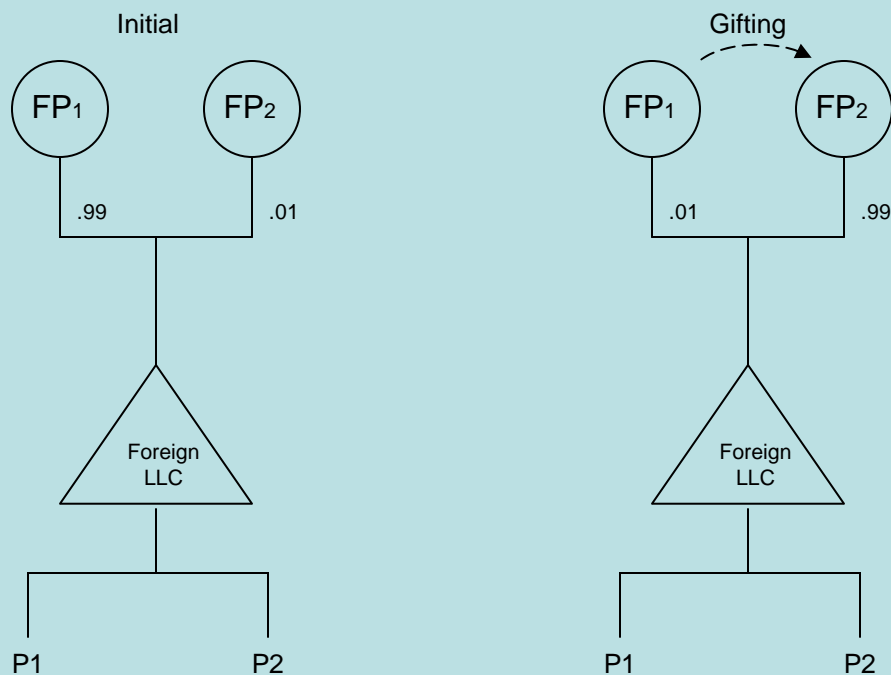


Residence Property Ownership



- 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

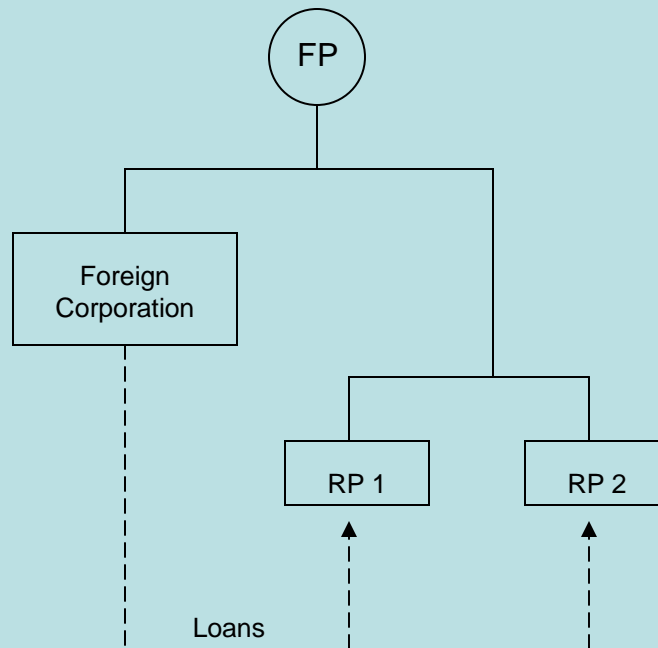
- Single Level of Income Tax
 - FP pays tax
 - FP qualifies for 15% capital gain rates
 - FP files annual returns to report U.S. income
- Partnership Interest = Intangible Property
- Partnership Interest [U.S. or foreign] is not subject to U.S. gift tax

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



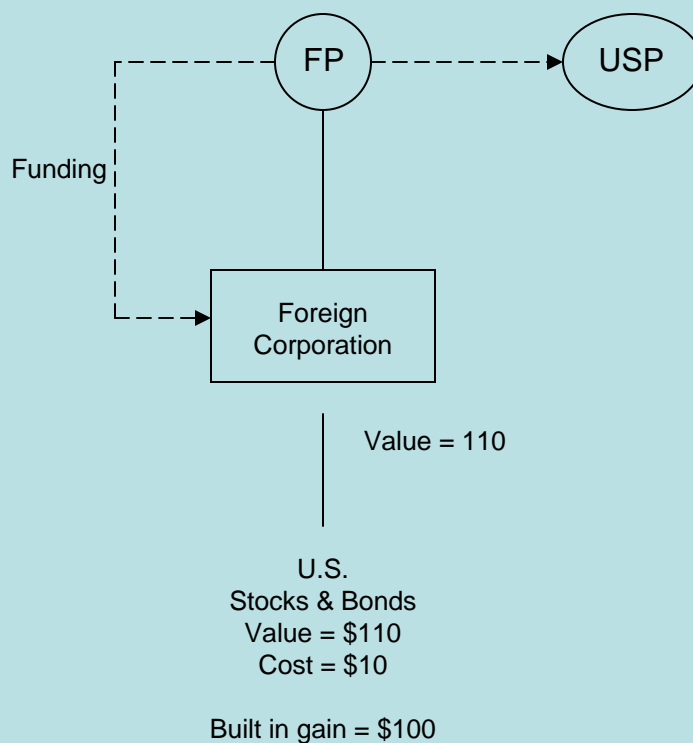
Use of Debt to Reduce U.S. Tax Exposure



- 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



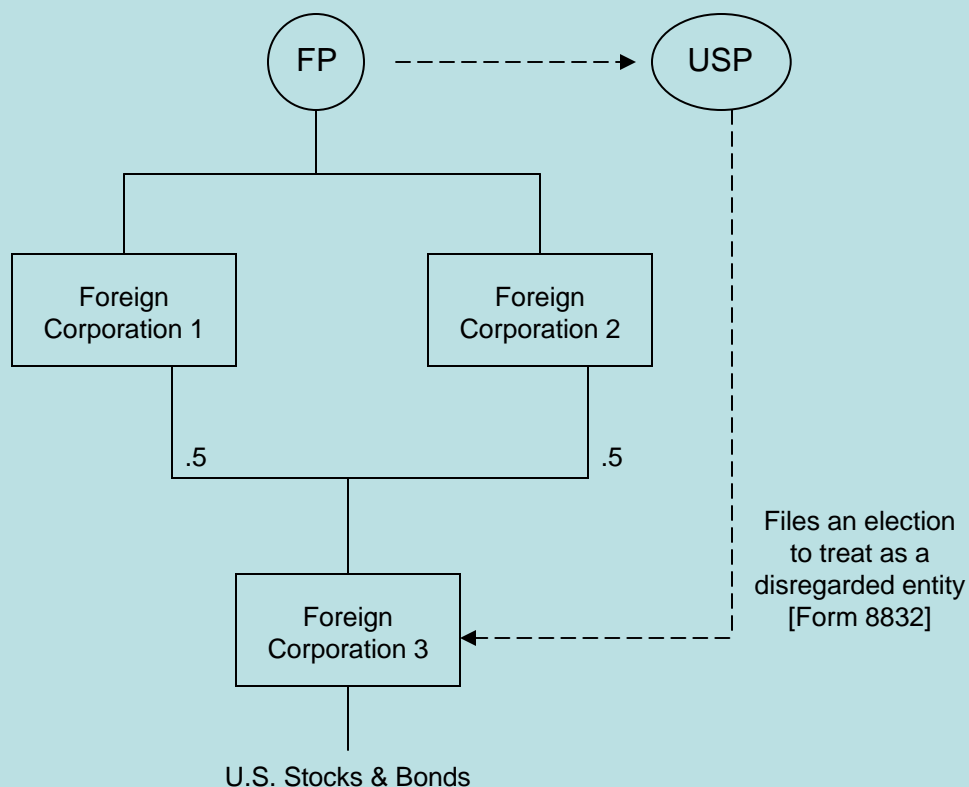
Problem with typical ownership

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]



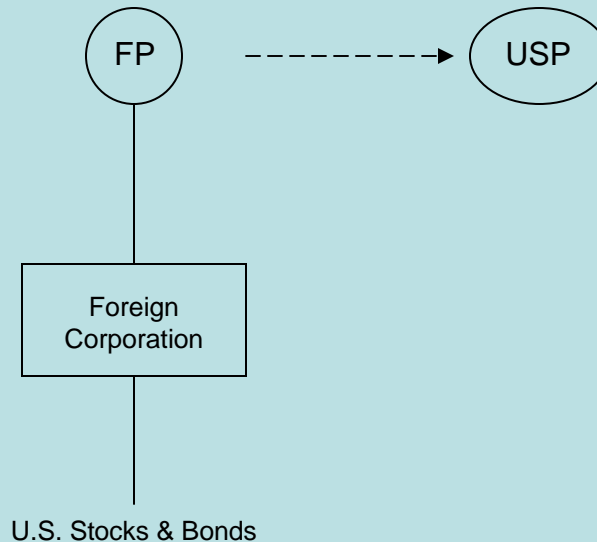
Solution # 1: Using a “Check-the-Box” Election



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 dividend 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?



