

# International Tax

## India – U.S. Tax Planning

January 24, 2011

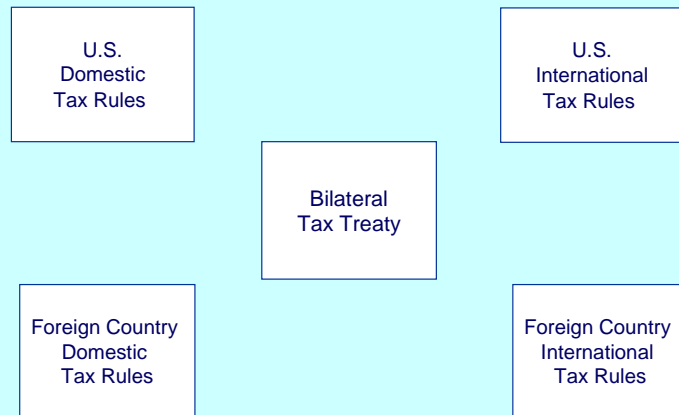
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## Interacting Tax Rules



## 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 <sup>(1)</sup>
  - Interest and Dividends – 30% tax rates
  - U.S. Trade or Business - 10% to 35% tax rates (same as U.S. residents) effectively connected with a U.S. trade or business <sup>(2)</sup>
- (2) Not Taxed
  - Capital gains (unless in U.S. over 183 days) <sup>(3)</sup>
  - Interest if defined as “Portfolio Income” <sup>(4)</sup>
  - Exempt individuals (government, trainees, students, athletes) <sup>(5)</sup>
- (3) Treaty Override of U.S. Rules
  - India – U.S. Income Tax Treaty reduces the 30% royalty tax rate to 10% (Article 12)
  - U.K. – U.S. Income Tax Treaty reduces the 30% royalty tax rate to zero (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) <sup>(6)</sup>
- Lawful permanent resident (Green Card)
- Citizenship

Elections:

- If present in U.S. for 31 days and 75% of subsequent days in election year <sup>(7)</sup>
- Married to a resident or citizen and electing to file a joint return <sup>(8)</sup>
- Visa generally not a factor for determining tax residence

## 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	
2011	120	1	120
2010	120	1/3	40
2009	120	1/6	<u>20</u>
			180

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

## Income Tax Treaty

Treaty tie-breaker test may override "green card" status

Article 4: Tie Breaker Test – India – 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 India or the United States
  - Permanent home
  - Center of vital interests
  - Habitual abode
  - Nationality
  - Competent authorities
- In general to qualify, the foreign national must be subject to tax in other country

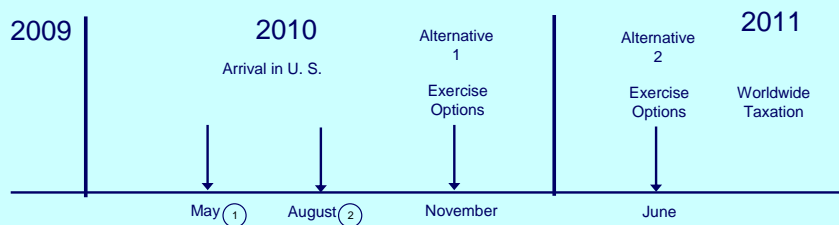
## Pre-Arrival Planning

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
- Pre-arrival gifting to U.S. or non U.S. persons

## Exercising Stock Options: Timing is Everything

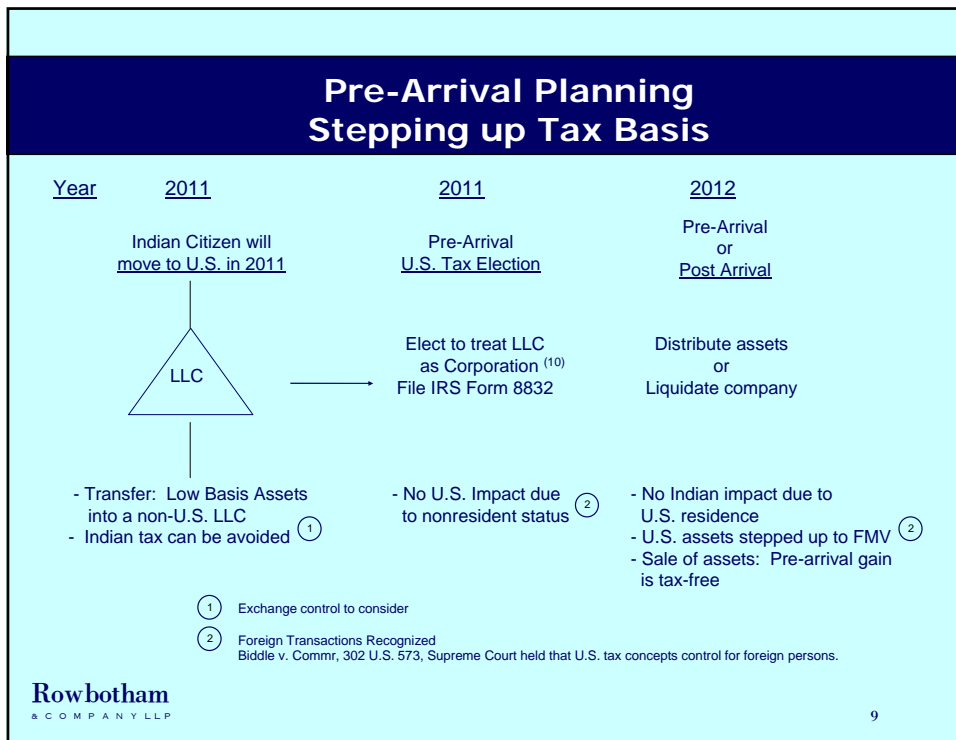
Options awarded in 2008



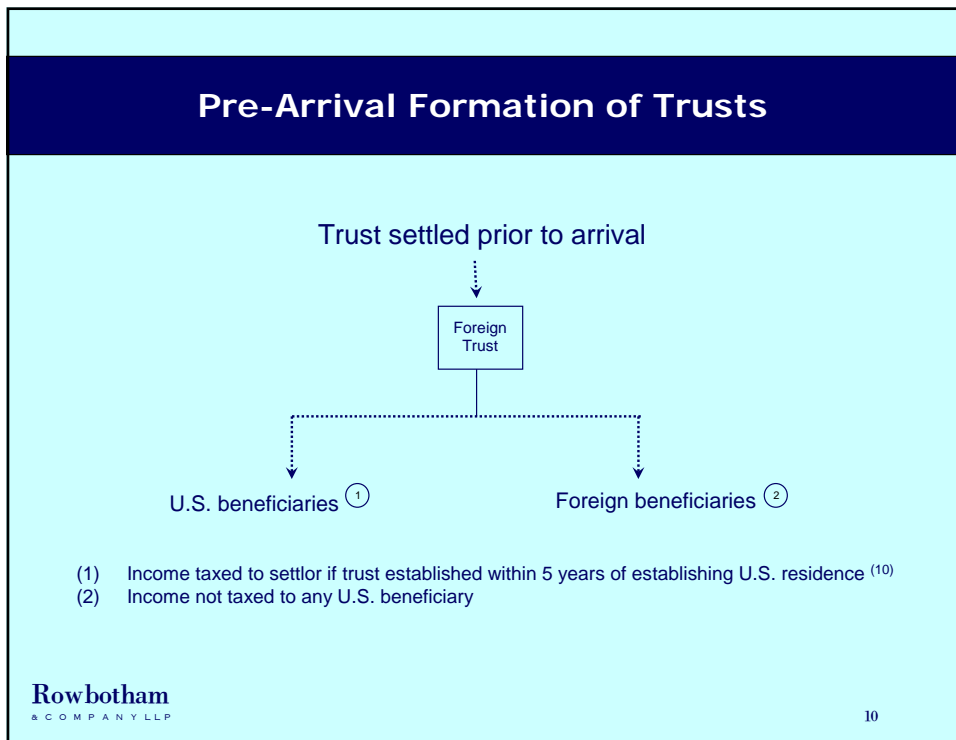
Early exercise avoids taxation of "in the money options"

- (1) An incoming foreign national will generally be a resident from May – December 2010
- (2) An incoming foreign national will likely be a nonresident for all of 2010

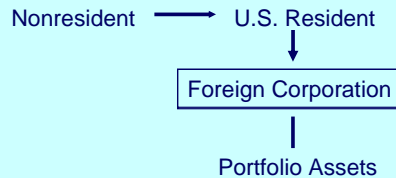
## Pre-Arrival Planning Stepping up Tax Basis



## Pre-Arrival Formation of Trusts

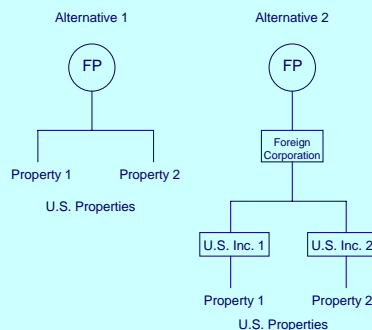


## Pre-Arrival Planning Liquidating Controlled Foreign Corporation



- Consider liquidating foreign corporation prior to becoming a U.S. resident
  - In general, holding assets in a controlled foreign corporation creates unnecessary tax complexity, increased taxes, and additional tax reporting
  - Controlled Foreign Corporation rules will convert capital gain into ordinary income <sup>(1)</sup>
  - Investment income will be taxed currently to U.S. resident

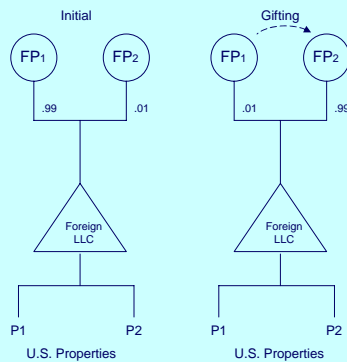
## Foreign Investment in Real Property Tax Act [1980] "FIRPTA"



### 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

## Expatriation

When do these rules apply? <sup>(13)</sup>

Applies when:

- (1) Annual income tax over prior 5 years averages > \$124k
- (2) Fair market value of assets > \$2 million
- (3) Person is giving up: U.S. citizenship, long term residency
  - U.S. Citizenship
  - Resident green card if person was resident for 8 of prior 15 years
  - Filing as a nonresident can be a deemed disposition after 7 years
- (4) Residence will resume for any year that presence in the U.S. exceeds 30 days

## Expatriation

### Outcome of Expatriation

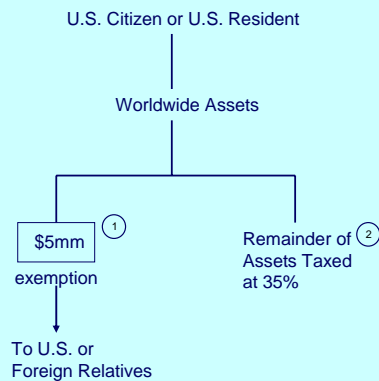
#### Income Tax:

- There is a deemed disposition of assets
- Gain is taxable at normal U.S. tax rates

#### Gift & Estate Tax

- Expatriate subject to U.S. estate and gift tax to same extent as other non-U.S. residents – only on U.S. sited assets
- Transfers by expatriates to U.S. beneficiaries may subject beneficiaries to U.S. tax

## U.S. Estate Planning



(1) Exemption goes to \$1 million in 2013

(2) Unlimited marital deduction available for U.S. spouse.  
Deferral is permitted until non-U.S. spouse dies if a qualified domestic trust is formed.

## Estate Tax Rates and Exemption Amounts

For Decedents Dying During	Top Estate Tax Rate	Exemption Equivalent **
2009	45%	\$3,500,000
2010	35% (optional)*	\$5,000,000
2011	35%	\$5,000,000
2012	35%	\$5,000,000
2013	55%	\$1,000,000

\* Executor may elect estate tax with increased exemption and step up basis of assets, or elect no estate tax with modified carry-over basis in assets.

\*\* Exemption equivalent amount for nonresidents is limited to \$60,000 for all years.

## Gift Tax Exclusions and Unified Exemption

- Annual exclusion – \$13,000

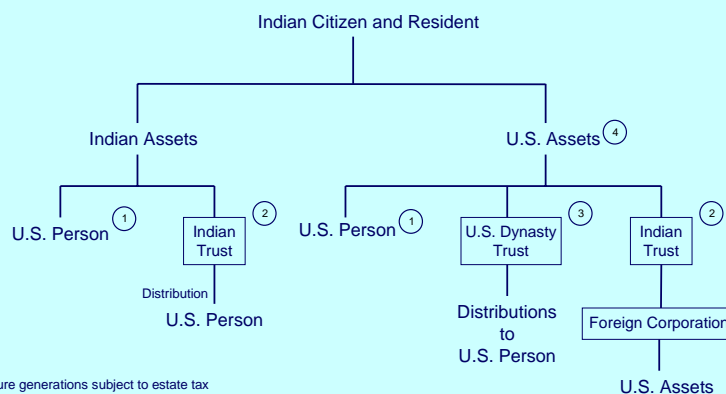
For Gifts During	Exemption Equivalent
2010	\$1,000,000
2011	\$5,000,000
2012	\$5,000,000
2013	\$1,000,000

- Gifts using exemption reduce estate tax exemption dollar for dollar
- No exemption allowed for nonresidents

## Exemption Portability

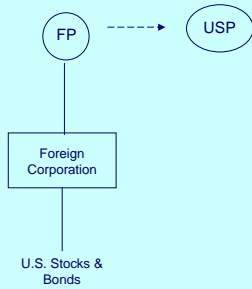
- Unused estate tax exemption amounts remaining after the death of a spouse may be used by the estate of the surviving spouse.
- Example: Husband dies in 2011 with a \$3 million estate. As of Husband's death, Wife has made no taxable gifts. Thereafter, Wife's applicable exclusion amount available is \$7 million (her \$5 million basic exclusion amount plus \$2 million "carryover" unused exclusion amount from Husband), which she may use for lifetime gifts or for transfers at death.
- Carryover of exemption available only if election made on timely filed estate tax return for decedent spouse.

## U.S. Estate & Trust Planning



- (1) Future generations subject to estate tax  
 (2) Assets avoid U.S. estate tax  
 (3) Assets avoid U.S. generation skipping tax  
 (4) Exemption amount limited to \$60,000 for nonresidents

## Avoiding Problems for U.S. Beneficiaries



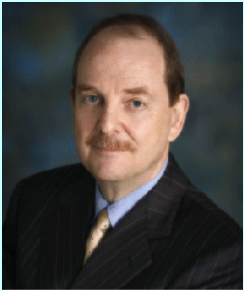
At date of death:

- 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 <sup>(12)</sup>
    - Outside gain not taxed since basis in foreign corporation stock steps up

## 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)
- (13) Code § 877A

# Rowbotham & Company LLP



Brian Rowbotham is a CPA with 33 years of experience advising businesses and individuals on complex domestic and international income and estate tax planning.

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.

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