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Executive Newsletter

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The Offshore Investment Conference - Shanghai 2010

August 3, 2010

Harriet Leung and Brian Rowbotham were speakers at the annual Offshore Investment Conference in Shanghai, June 9th and 10th.

Their presentation was about International Tax Planning for Asian Families.

The speakers and attendees for this year's conference came from around the globe to discuss cross border business opportunities being generated by the red hot economy in China. The following comments summarize insights into the Chinese economy from the Investment Conference, from the Shanghai World Expo which was held concurrently, and from several clients and advisors in Shanghai.

By Harriet Leung

1. The Shanghai economy is booming.

The Chinese government invested U.S.$4 billion in Expo alone, and an additional U.S.$58 billion in infrastructure projects in and around the city, including significant upgrades in rail transportation.

Huge amounts of capital have been invested in security. In every Metro station, riders must send their bags through airport like x-ray machines. The government wants to insure that the City is free of any incidents while Expo is in process.

Among the local businessmen, there is a lot of pride in the economic success achieved in Shanghai in such a short time period, along with an attitude of optimism. It's a bit like the dot com period in Silicon Valley in the late 1990s. Due to inflation concerns particularly in the real estate area, there is a degree of reserve about the economy overheating. There is a constant "bubble" or "no bubble" debate in the press, both locally and internationally.

2. China is gearing up for global leadership, reflected in their seriousness about education.

While in Shanghai, the President, Hu Jin Tao unveiled the government's plan to be a center of global innovation. Billions of dollars are being invested in the local universities and think tank centers.

Education is being seen as the key to the country's future. During our stay, the papers were full of the anxiety and anticipation for the 10 million students sitting for the national exams to qualify for the top Universities. The pressure is even more intense due to the "one child" policy where parents see their own well being based on the ability of their only child to perform well in their studies.

It was unusual to see such focus on entrance exams. You don't see Americans get this excited unless it's Super Bowl week. The testing centers were all on high security alerts, metal detectors were in place to prevent cheating devices and the internet was being screened for sales of various software and hardware devices that facilitate cheating. In areas where new construction was in progress, activities would shut down so the noise factor wouldn't interfere with students in testing centers. Last year there were riots, and troops had to be brought into several testing centers to keep the parents from causing problems. The testing period passed this year without incident.

3. Doing business in China is not without its political side.

Our conference was held in the Pudong Shangri La Hotel for three days. On day two, Iran's President Mahmoud Ahmadinejad and his entourage arrived from Tehran. China has emerged in recent years as Iran's main trading partner. Its policy with respect to Iran is to push the diplomatic process rather than imposing sanctions over Tehran's nuclear program. While the Chinese voted to impose sanctions on Iran in the UN Council, both sides need each other, so the practical side of policy prevails. To Westerners, it looks somewhat duplicitous to sanction Iran and then welcome its leader, but to the Asian businessman, the practical side of politics is the approach. In China, Western attitudes in the political arena can at times seem self-righteous.

4. Hong Kong still plays a major role in Shanghai and China.

The financial infrastructure and experience of professionals in Hong Kong are still among the best in the world, giving Hong Kong the capacity to take on the fast paced growth in financial transactions. However, it would be a mistake to underestimate the desire and capability of Shanghai in particular to gain market share as their economy grows.

While Shanghai is gearing up to be a major financial center like New York, much of the financial strategy and planning is still overseen or managed by financial institutions, consultants and trust companies based in Hong Kong.

Chinese investors are still burdened by government regulations and exchange control so it's very typical to see businesses in China either affiliated with, or owned by companies that are headquartered in Hong Kong. When China based businesses expand beyond their borders, it's typically easier for such companies to move capital to the U.S. or Europe or other parts of Asia through a Hong Kong parent or affiliate company, for legal, tax and exchange control reasons. For now, Hong Kong and Shanghai are like business partners although they both compete when it comes to attracting new businesses from abroad.

5. Opportunities for U.S. business expansion are excellent for those who are careful.

The demand for U.S. products and the desire to invest into the U.S. market, and in particular, into U.S. real estate is immense. There is tremendous liquidity in China but due to exchange controls, it's challenging for locals to do a lot of investing outside China without approval from the Central Bank which is controlled by the government. For local businesses, expanding overseas is encouraged and moving capital outside of China is allowed, but for the pure investor, it's hard to do.

Exchange control constraints force much of the investible capital to go into the local stock markets, which aren't overwhelmingly popular, and into the local real estate market which continues to heat up. The government operates like the Federal Reserve in the U.S. but its financial powers are much broader. For second homes, the cash down requirement was recently increased from 40-50%, and for a time, third home purchases were not allowed in an effort to slow down the cost of real estate which is quickly pricing out most middle class people.

The government is currently implementing a number of programs to assist local companies with acquisitions in the U.S. The scale of these programs and the capital being committed is vast when compared to most economies around the world. While all this is good, we'll likely see a "controlled increase" with inbound investments into the U.S. as opposed to a flood, so the American businessman must be very patient.

Doing deals and negotiating terms are complex. Shanghainese are famous for being bargain hunters and this culture plays directly into day to day business. *Caveat emptor* or buyer beware is an absolute necessity to survive. Due diligence takes much more time and effort than in the U.S., but is an absolute essential ingredient to any undertaking.

Harriet Leung is a certified public accountant. She is the partner in charge of the firm's Asian business practice. Ms. Leung's client base includes companies in real estate (domestic and foreign), international investments funds, life science, financial services and distribution. Harriet is fluent in Mandarin and Cantonese.

For additional information regarding dong business in China, contact Brian Rowbotham.

Firm newsletters on other subjects can be viewed at our website.

Rowbotham & Company is a Certified Public Accounting firm that provides accounting services and domestic and international tax consulting to individuals and businesses of all sizes, including large multi-national companies, both public and private. The firm responds to complex business challenges with experience and care. The firm is registered with the Public Company Accounting Oversight Board (PCAOB), which entitles it to practice before the SEC.

Rowbotham & Company has offices in San Francisco and the Silicon Valley and is a member of the AICPA and Polaris International, a worldwide association of accounting and consulting firms. www.rowbotham.com.

Click here for more information about our firm and its service areas.

OFFSHORE INVESTMENT

U.S. – INTERNATIONAL TAX PLANNING
AN ASIAN PERSPECTIVE

June 9th and 10th, 2010
SHANGHAI

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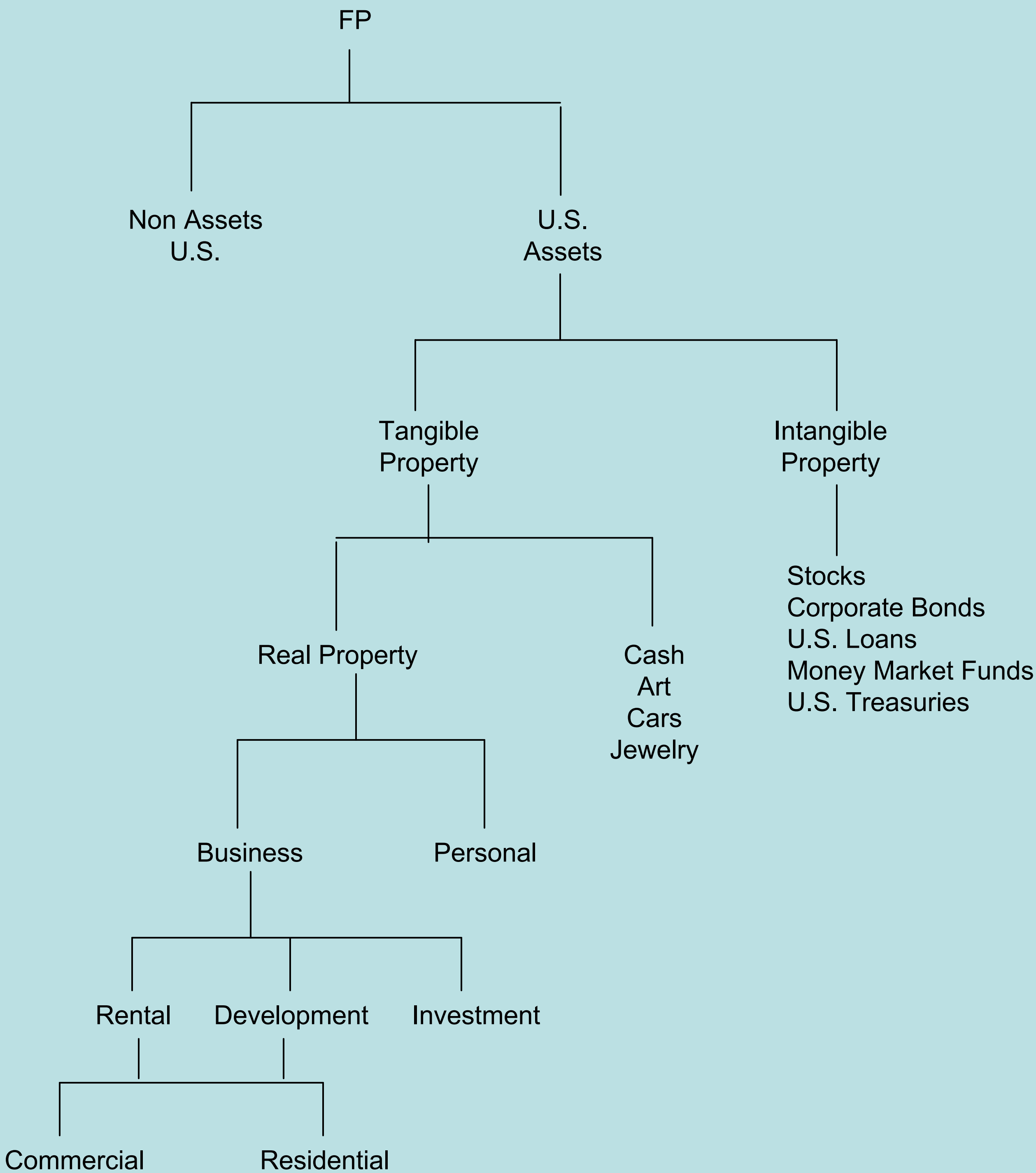
International Tax Planning

Ownership of U.S. Assets



Income Tax Rates

Individual Income Tax Rates	Federal	Average State	Total
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	200
Gain	100

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

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)]

	Tangible (T) or Intangible (I)	U.S. Gift Tax	U.S Estate Tax
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

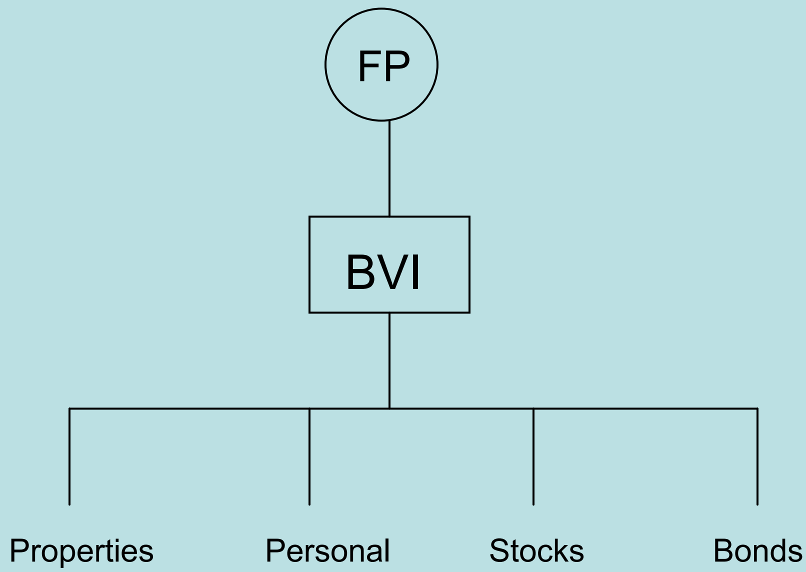
<u>Exemptions:</u>

Gift Tax - $13,000 per year annual exemption

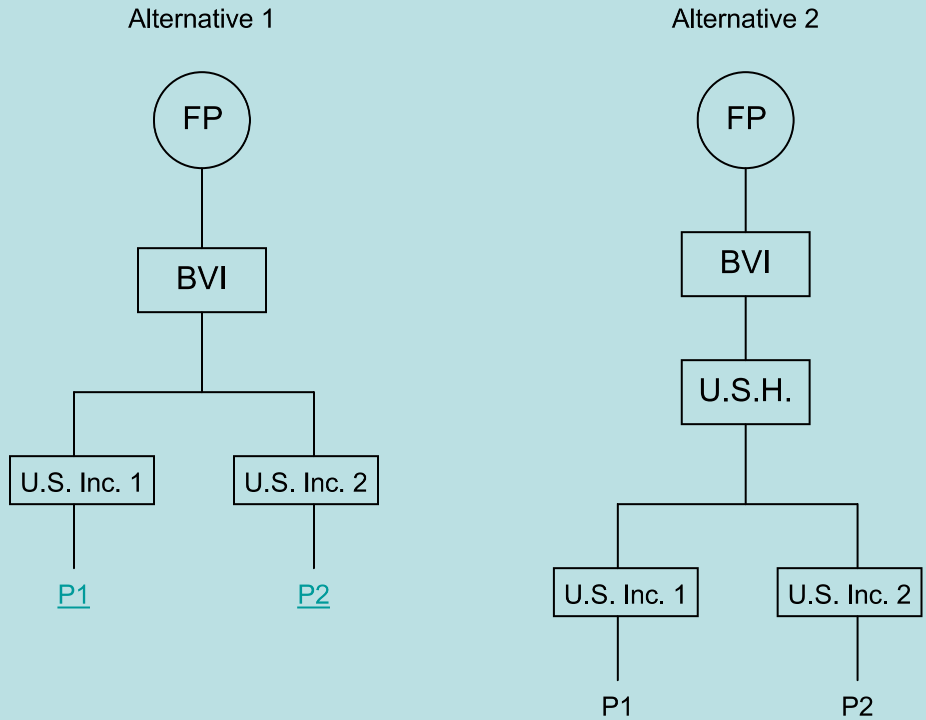
Estate Tax - $60,000 exclusion

Typical “One-Stop Shop” Solution

Typical Structure



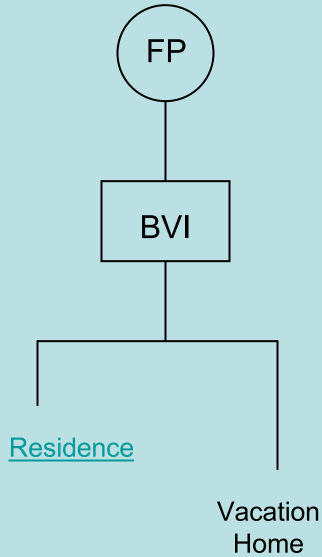
Foreign Investment in Real Property Tax Act [1980] “FIRPTA”



Foreign Corporation Structure

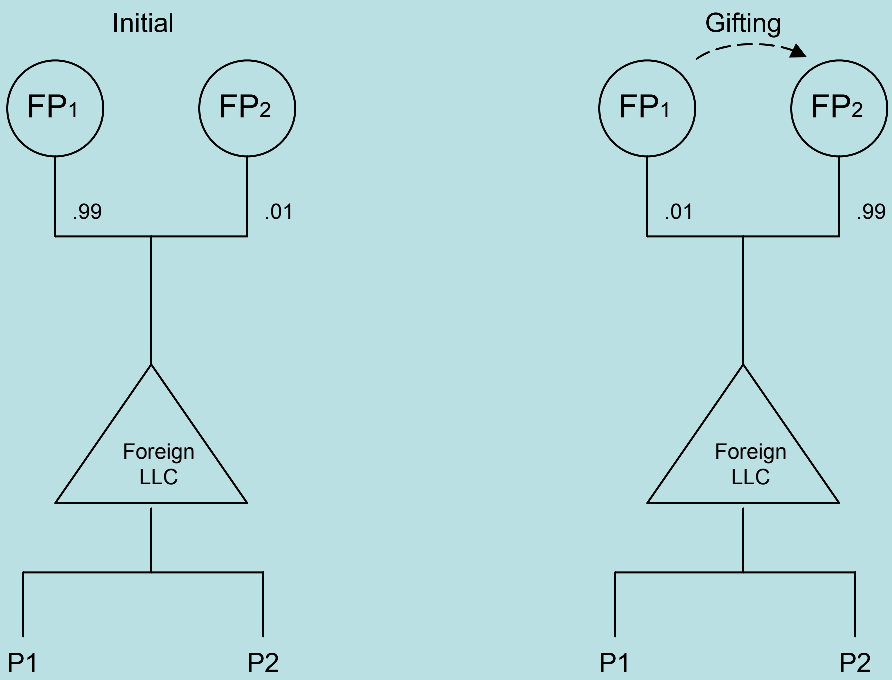
- Estate tax eliminated by foreign corporation
- Corporate tax rates on income and on gains
- Dividends paid by foreign corporation = 30% [lower treaty rate] withholding tax
- Confidentiality for ultimate foreign owner
- Sale of all U.S. property and liquidation of U.S. corporation [tax-free] avoids 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



<u>Partnership Benefits compared to ownership through foreign corporation</u>

- 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

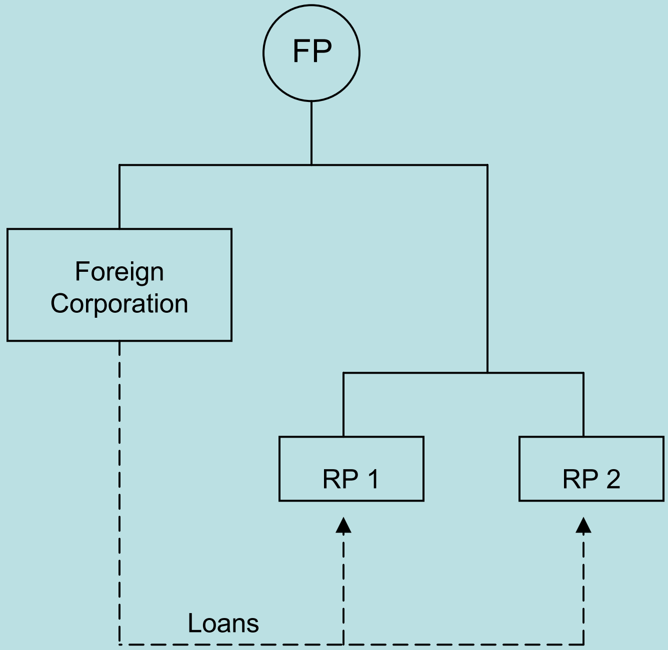
<u>Risk</u>

- 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

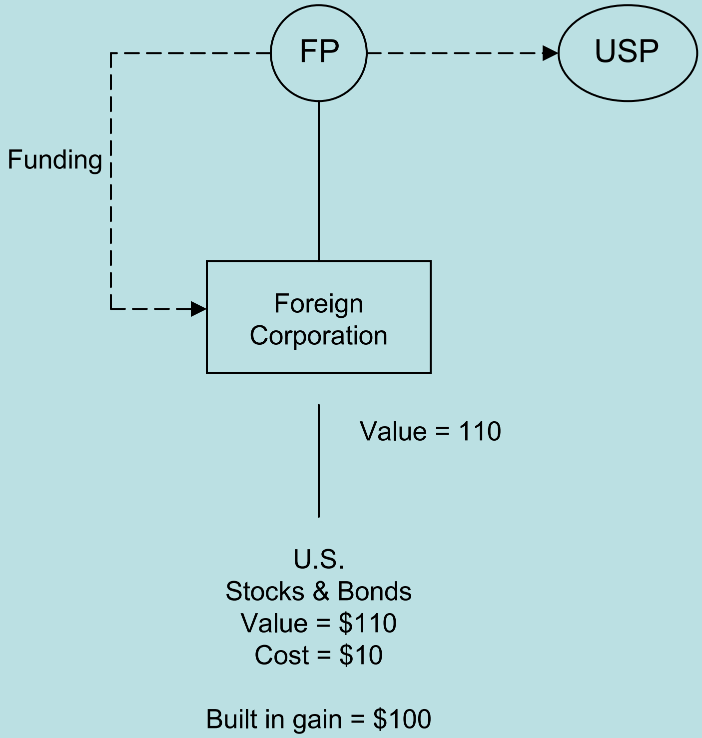
    (b) an interest in real property?
- Estate tax rules are unclear
  - Practical approach

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

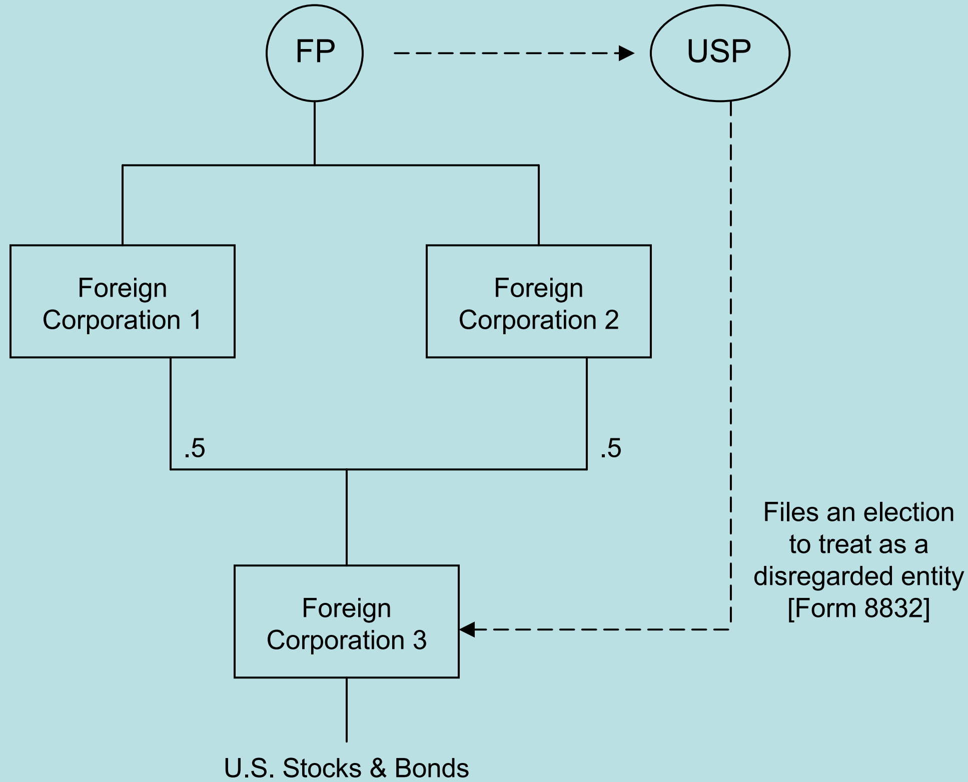


<u>Problem with typical ownership</u>

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.

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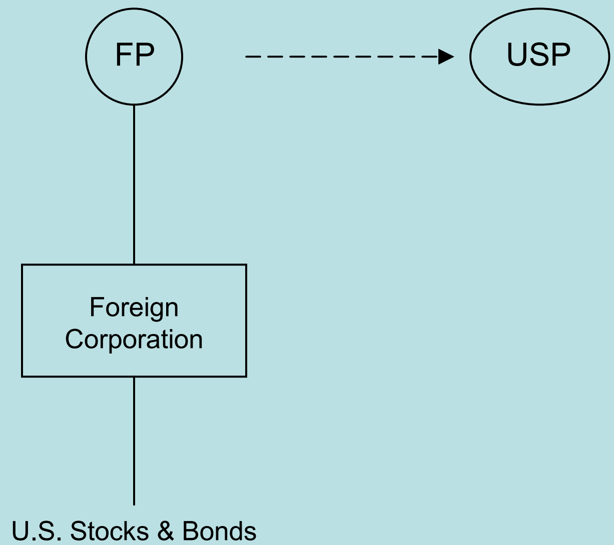
Solution # 2: Thirty Day Liquidation



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?

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. 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.