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SO WHAT'S MY TOP TAX RATE GOING TO BE IN 2011? 2010 Year End Planning

October 22, 2010

We've been answering this question in a number of different ways to various clients. With the uncertainty about the Bush tax cuts ending this year, one would think estimating your top tax rate is a simple matter of 35% (current) vs. 39.6% (proposed). However, upon close examination, the answer is **generally "no difference, even if the higher rates apply!"**

One's ultimate tax liability is the higher of two calculations: regular income tax or alternative minimum tax ("AMT"). If you're subject to the top AMT rate of 28%, your tax may not change at all.

Let's assume you're a high income earner (income in excess of \$400,000) with capital gains, and also have mortgage expenses, property taxes, charitable contributions and investment expenses. In most cases you'll hit the alternative minimum tax rates.

The following is an example:

	ORDINARY TAX	AMT
	(\$000)	
1. Gross income		
a. Wages	400	400
b. Capital Gains	100	100
	500	500
2. Less: Deductions from AGI and Itemized Deductions		
a. Interest	30	30
b. Taxes (property and state income taxes)	50	0
c. Charitable Gifts	10	10
d. Miscellaneous Expenses	20	0
	390	460
3. Equals: Taxable Income before Exemptions		
Tax Liability		
Ordinary Income Tax	118	
Alternative Minimum Tax		125

The AMT catches so many people because substantial deductions are disallowed under the AMT calculation. If you have substantial deductions not permitted under the AMT rules, while your ordinary tax calculation can drop dramatically, the AMT calculation remains static at a high rate of 28%. Accordingly, it may not take huge deductions to push your ordinary tax

calculation below the AMT calculation. In the above example, if the ordinary income tax rate increased by 4.6% to 39.6, the increase in tax would not push the \$118,000 figure past the \$125,000 tax under AMT, so one's taxes would remain the same.

In 2011, if the top long term capital gains rate changes from 15% to 20%, the capital gains tax on \$100,000 in both columns will increase by \$5,000.

Investors with substantial long term capital gains almost always end up in AMT because the state income taxes are deductible under the regular income tax but not under the AMT calculation.

In the above example, the taxpayer is subject to AMT with the following results:

- Prepaying income or property taxes in 2010 would not result in any tax savings this year.
- Contributing to a charity will result in a 28% tax benefit since charitable deductions are permitted under the AMT calculation.
- Accelerating income from 2011 into 2010 might be an excellent strategy given the increase in the tax rates that might apply in 2011, but may also be needless if you're still in the 28% AMT rate next year.

To return to the question about your top tax rates for 2011, the answer will mostly depend on what makes up your income. For example, the top tax rate on dividends can possibly go from 15% to 39.6% in 2011. Your top tax rates in 2011 could be:

	CURRENT 2010 RATES		2011 HIGHER RATES	
	Ord Tax	AMT Rates	Ord Tax	AMT Rates
Earned Income	35%	28%	39.6%	28%
Dividends	15%	15%	39.6%	28%
Interest - Other Ord Income	35%	28%	39.6%	28%
Capital gains - Long term	15%	15%	20%	20%

We've all become economists in the last two months, debating whether higher taxes will help or hinder the economy. The real economists are split on this question or prefer to sit on the fence by talking about whether more stimulus is good or bad for the economy.

We've all been abandoned by Congress and the economists. However, we will not do the same. Here is what you need to do given the current uncertainty as things stand today:

1. Estimate what your income and deductions will be for 2010 and 2011 (use 2010 estimates for both years if you don't know what next year will bring).
2. Calculate your tax under the current rates.
3. Calculate your tax under the worst case scenario using the 2011 rates.
4. Do nothing.
5. Wait until November 3 - the day after the elections.
6. Call your tax advisor.
7. Don't delay with (1) or (2). It takes time and documentation to properly implement good year end tax planning moves.

Rowbotham & Company can help with analyzing your tax situation and recommend some year end planning steps. Please contact [Harriet Leung](#) or [Peter Trieu](#) for further assistance.

FIRM ACTIVITIES

Investing in U.S. Real Property: Asian Perspective - Real Estate Roundtable

Members of the firm recently gave a presentation at the Real Estate Roundtable on various tax structures and strategies for foreign investment in U.S. real property.

The presentation contains additional thoughts on year end planning for foreign investors.

[Click here](#) to view the presentation.

Contact [Harriet Leung](#), Partner, Asia Practice if you have any questions.

Firm newsletters on other subjects can be viewed at our [website](#).

Rowbotham & Company is an accounting and consulting firm that provides domestic and international accounting, tax and consulting services to individuals and businesses including closely held corporations, investment partnerships and funds, venture backed technology enterprises and large multinational companies, both public and private.

The firm is registered with the Public Company Accounting Oversight Board (PCAOB), and is qualified 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.

[Click here](#) for more information about our firm and its service areas.

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Real Estate Roundtable - Educational Forum
U.S. Real Property Investment – An Asian Perspective
October 14, 2010 ~ City Club

from Shanghai...

...to San Francisco



Harriet Leung

Brian Rowbotham

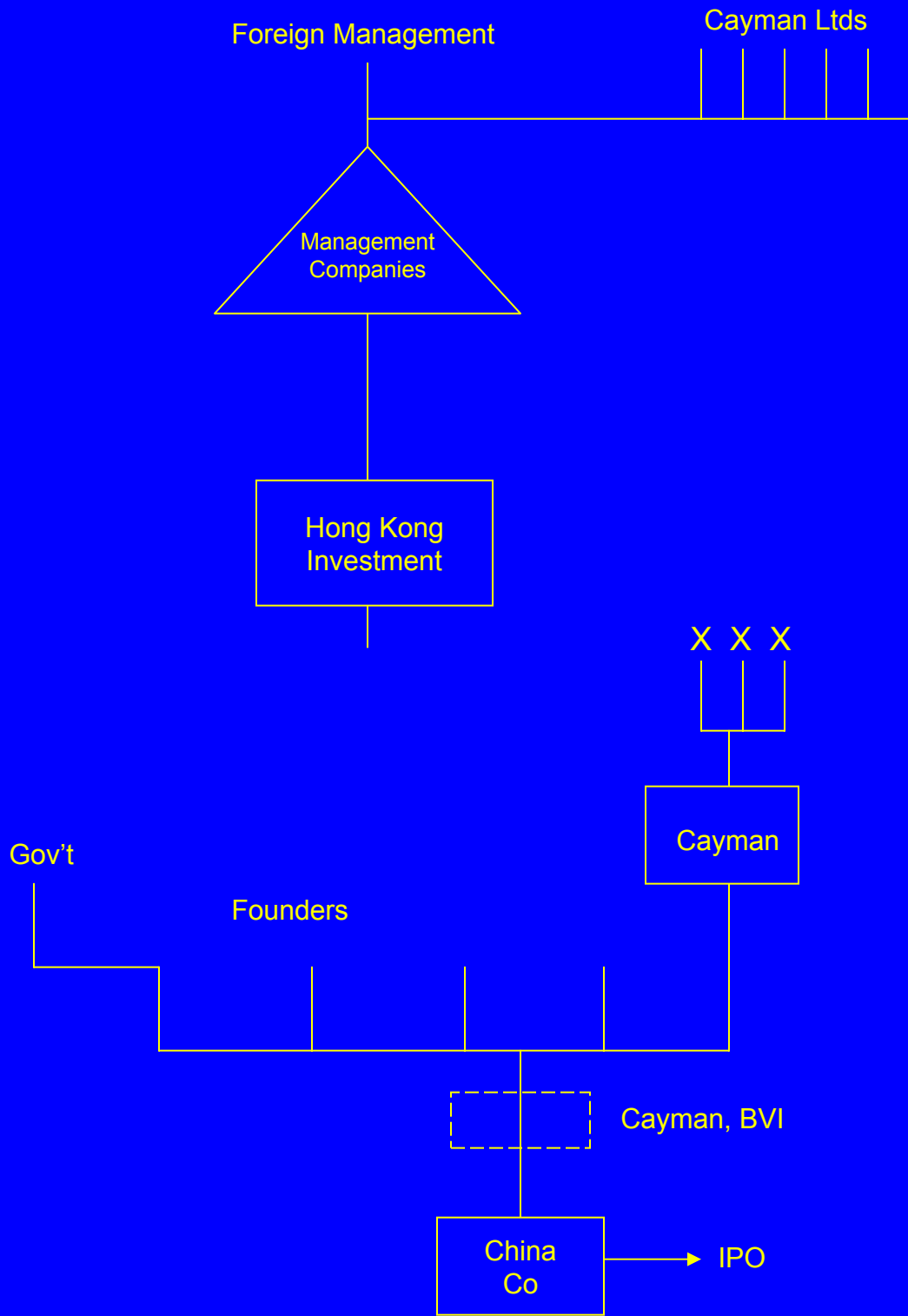


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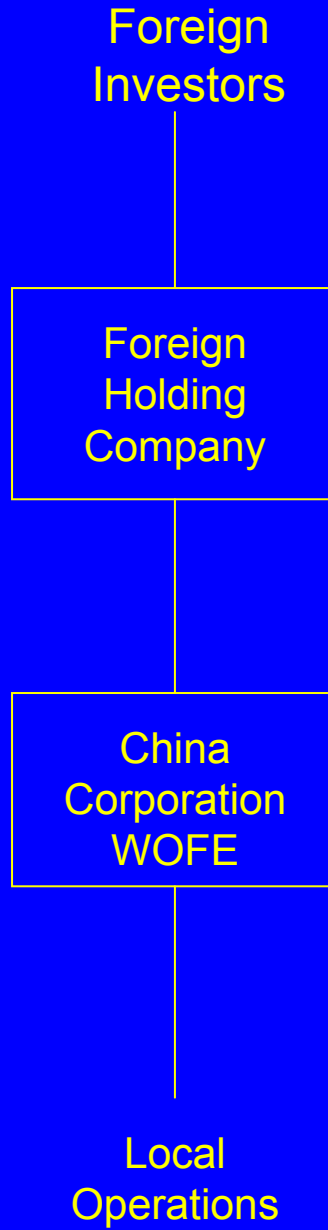
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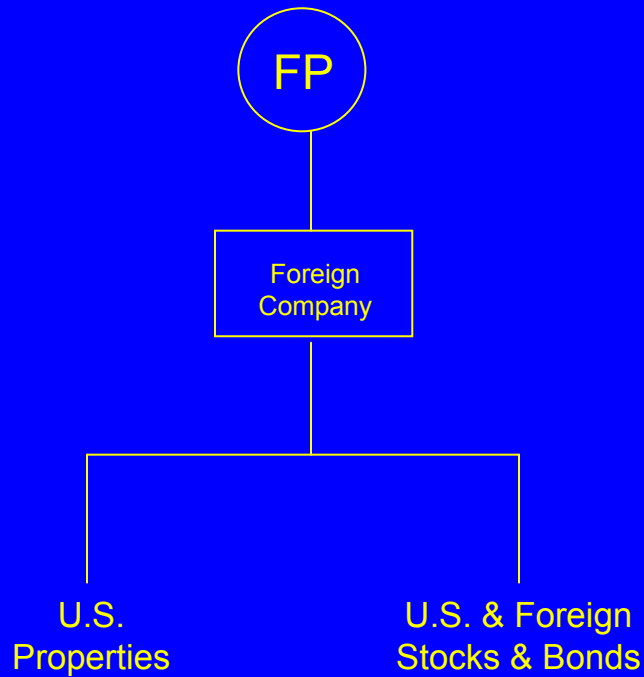
China Structures



Investing into China Today



Typical “One-Stop Shop” Solution



Foreign Ownership of U.S. real property

- + Estate tax protection
- + No gift tax on transfers of foreign stock
- U.S. real estate gains in FC taxed at combined federal and state income tax rate of 40%
- Possible “branch profits tax” on “dividend equivalent”

U.S. Gift & Estate Tax Rates & Exemptions

Residents & U.S. Citizens

Gift Tax Exemptions:

Annual	\$13,000
Lifetime	\$1 million

Estate Tax Exemptions:

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	55%

?
?

Nonresidents

Gift Tax Exemptions:

Annual	\$13,000
Lifetime	NA

Estate Tax Exemption \$60,000 [?]

Assets Subject to U.S. Gift & Estate Tax

	<u>U.S. Gift Tax (1)</u>	<u>U.S. Estate Tax (2)</u>
<u>Tangible Property</u>		
Cash	Yes	No (1)
U.S. Real Property	Yes	Yes
Art	Yes	Yes (3)
Autos	Yes	Yes
Jewelry	Yes	Yes
<u>Intangible Property</u>		
U.S. Money Market Fund	No	Yes
U.S. LLC	No	- - - (2)
U.S. Stocks	No	Yes
U.S. Bonds	No	Yes

- (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

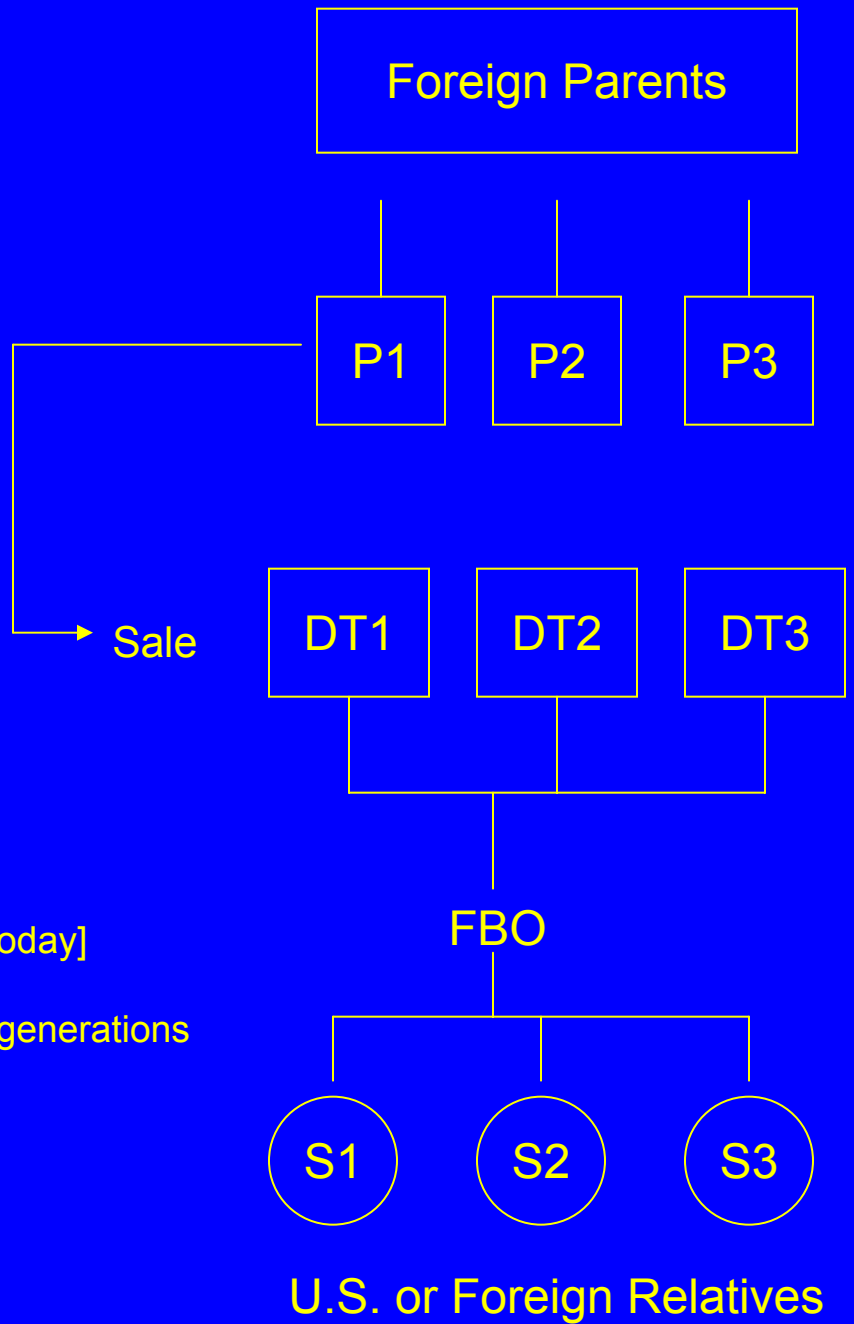
China Today

- General Rule: No gift tax
- Real Property
 - Family gifting exempt
 - Gifting to third parties subject to gift tax
- No Estate Tax

- (1) Gift Tax:
 - Property "situated in the U.S." [Section 2511]
 - Intangible property is excluded [Section 2501 (a) (2)]
- (2) Estate Tax: Property "situated in the U.S." [Section 2103]

Avoiding Transfer Taxes by Selling Property

Cost	100
FMV	101
	<hr/>
Gain	1
	<hr/> <hr/>



- Sale at depressed values avoid
 - gift tax
 - estate tax [for generations]
- Minimizes income tax [15% rates today]
- Dynasty trusts avoid tax for future generations

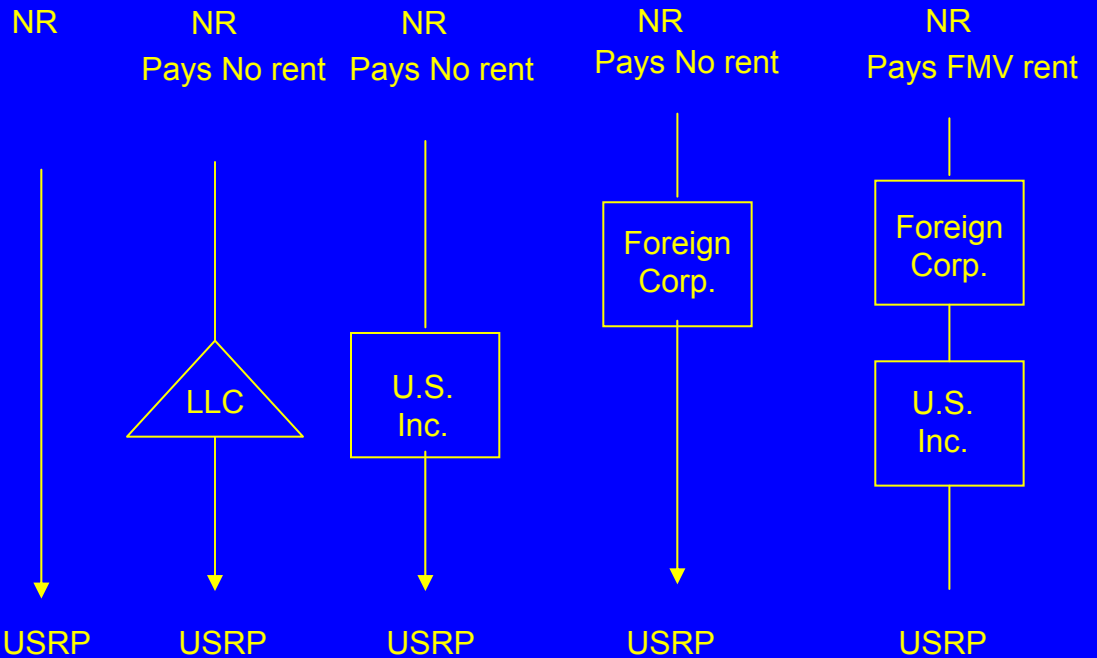
Income Taxation

	<u>Federal</u>	<u>State</u>
Individuals & Trusts:		
– Operating income	35%	0-12%
– Capital gains (sale of USRP)	15%	“
Corporations:		
– Operating income	35%	“
– Capital gains (sale of USRP)	35%	“
Foreign Corporations – second level tax:		
– Dividends from U.S. Corp.	30% ⁽¹⁾ ⁽²⁾	-0-
– Branch Profits Tax		
– Tax on dividends equivalent	30% or treaty	-0-

(1) Lower rates apply if income tax treaty exists

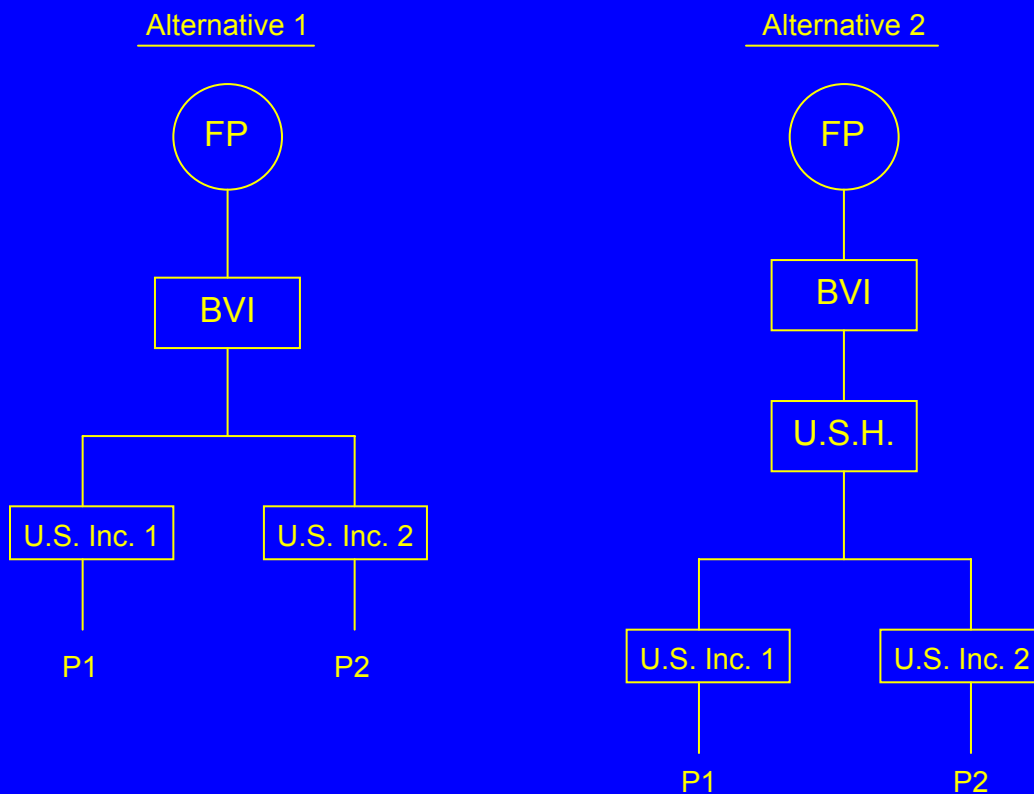
(2) U.S. – China tax treaty rate = 10%

Residential Property: Florida Beach House



	NR	NR Pays No rent	NR Pays No rent	NR Pays No rent	NR Pays FMV rent
Estate Tax	X	X	X	-0-	-0-
Risk Inclusion in Estate (Section §2036(a)(1))	-0-	-0-	-0-	X	-0-
Income Tax Risk					
Imputed Income §482	-0-	-0-	X	X	-0-
Branch profits tax §884	-0-	-0-	-0-	X	-0-
Lost deductions	-0-	-0-	-0-	X	-0-

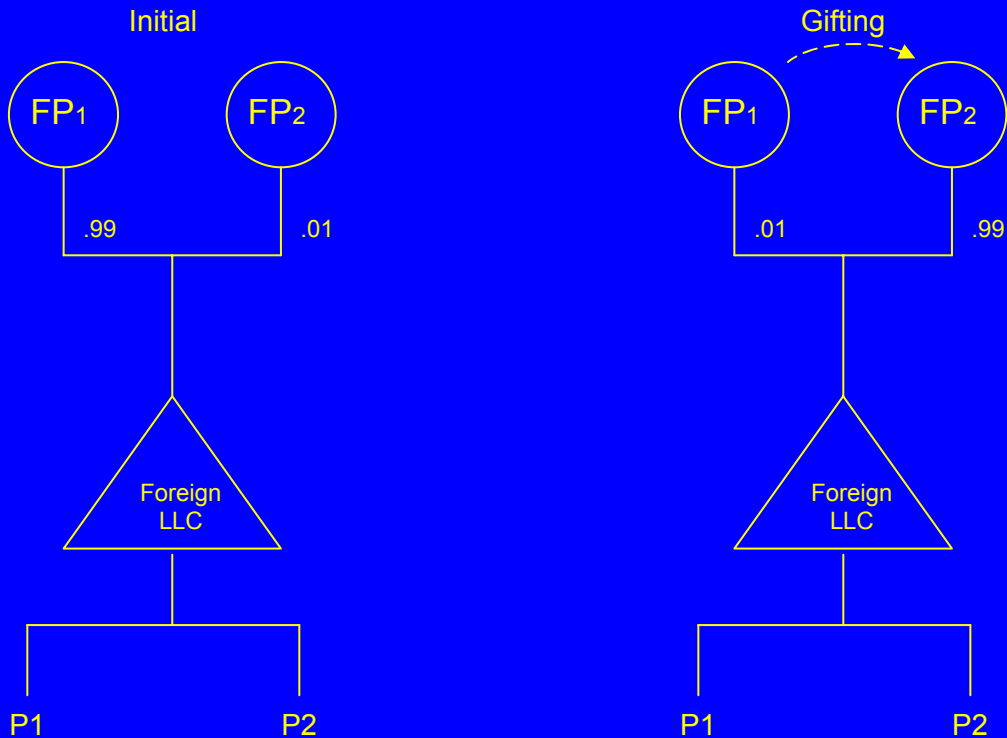
Commercial Property – Corporate Ownership



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 often 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

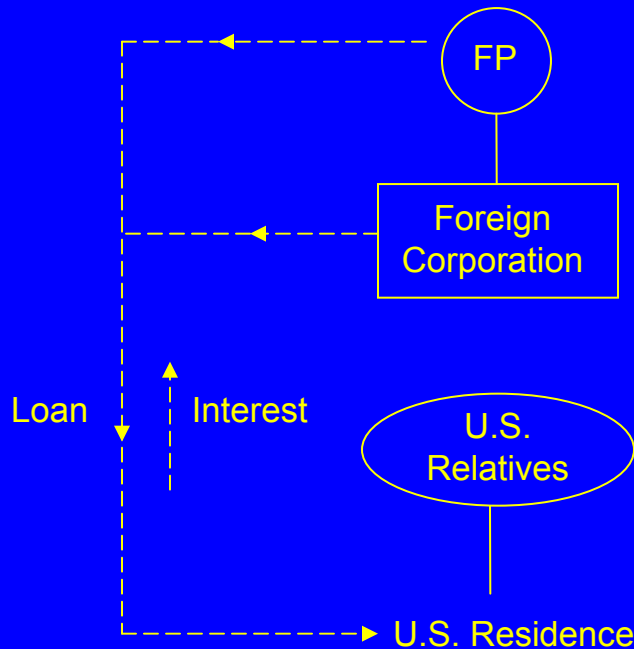
Commercial Property Ownership through Foreign Partnerships



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
- Partnerships have risk re: Estate Tax
 - See *Blodgett v. Silberman*, 277 U.S.1 (1928).
 - Rev Rule 55-701, 1955-2 C.B. 836
 - Estate taxation of partnership based upon situs:
 - location of partnership's trade on business?
 - owner's domicile?
 - where assets located?

Financing: Portfolio Interest Exemption



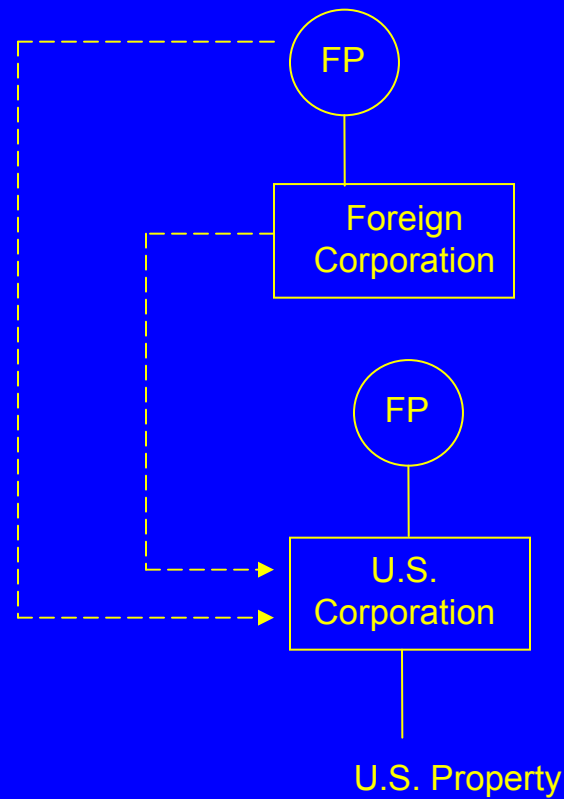
Normal Rule: Interest paid to foreign lender subject to

- 30% withholding tax, or
- Lower rate may apply under income tax treaty

Exception: Portfolio interest exemption if

- Unregistered obligations
- Held by non U.S. person (Section 871 (h))

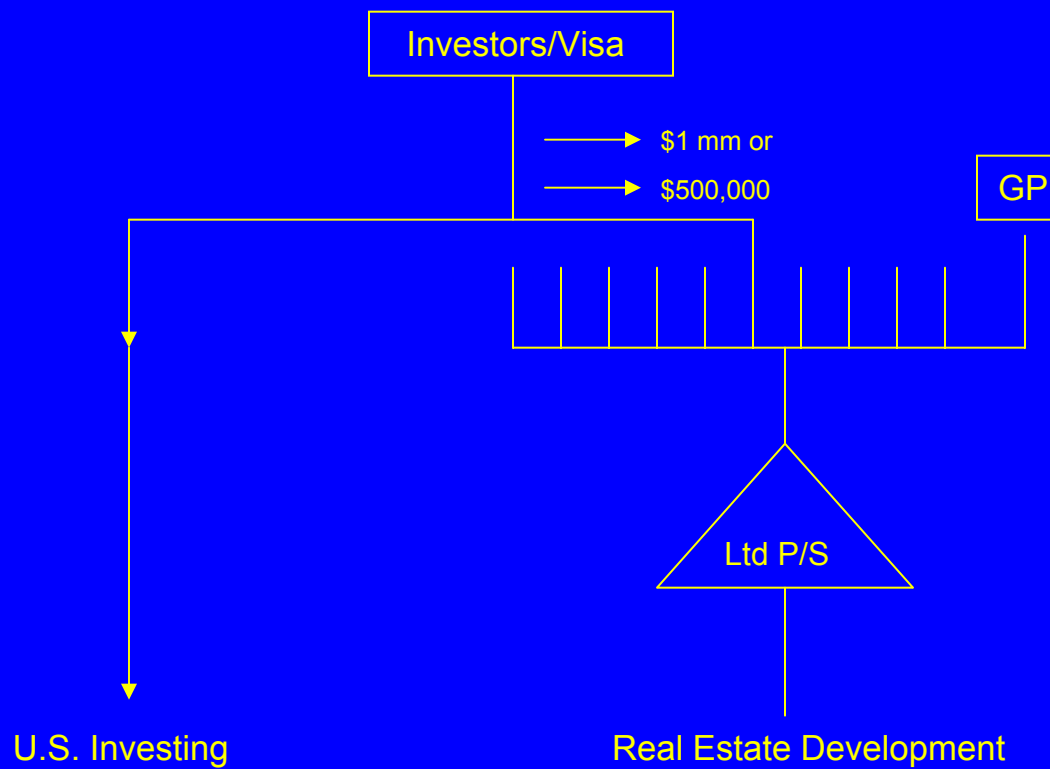
Corporate Financing



Related Party Loan to U.S. Corporations and Partnerships:

- Tax withholding on interest at 30% or treaty rate if FP or lender has 10% or more direct or indirect interest in U.S. entity
- Challenge: Confirming ownership

EB5 Program



Status

- Green card issued
- Wife & children reside in CA
- Husband runs businesses in China
 - U.S. presence of 4 months per year
 - Dual resident

U.S. Residence status in question

- Green card vs. Income Tax Treaty
- Treaty with China:
 - If dual resident, competent authority will determine where individual resides

Tax Traps for Investing in U.S. Property

(1) Withholding Taxes

- Maximum rates on income in U.S. or foreign partnership
- On sale of property by foreign person
 - federal 10%
 - state 3.3%
- No withholding on residence $\leq 300,000$

(2) Gift Tax

(3) Resident Status of Investors

(4) Property Tax Assessment

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Harriet Leung is a CPA and heads up the firm's Asian business practice engagements for private and public companies. 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's client base includes companies in real estate (including domestic and foreign), international investments, science, distribution, high-tech and software.

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.

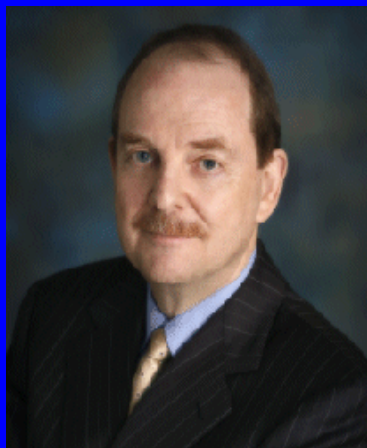
Ms. Leung earned a Bachelor of Science in Accounting with honors and a Master in Finance from Golden Gate University. She also received several scholarships and awards of distinction at Golden Gate University.

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, 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.



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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.



Rowbotham & Company LLP

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. The firm takes a global approach to client services and responds to complex business challenges with experience and care.

The firm provides a full range of audit and tax services. Frequent engagements include:

- ❖ Income and estate planning for executives and investors – domestic and international
- ❖ Audit services, Pre-IPO consulting services, and Sarbanes-Oxley compliance
- ❖ Merger and acquisition services, including due diligence and business valuations
- ❖ International tax planning and compliance
- ❖ Litigation support
- ❖ Assistance with federal and state tax audits

The firm works closely with client audit committees, CEOs, CFOs, and controllers and coordinates with foreign accountants or service providers, as needed. Industry experience includes:

- ❖ Distribution
- ❖ Financial Services
- ❖ Information Technology
- ❖ Investment Funds
- ❖ Life Sciences
- ❖ Real Estate
- ❖ Software

Founded in 1991, Rowbotham & Company has offices in San Francisco and Santa Clara and is a member of the Polaris International, a worldwide network of accounting and consulting firms. The firm is a member of the American Institute of Certified Public Accountants and is also registered with the Public Company Accounting Oversight Board, which entitles it to practice before the SEC. The firm maintains close ties to the legal, banking, and venture capital communities and frequently makes strategic introductions for its clients.

