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# Basics of International Tax & Estate Planning

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# How U.S. Multinationals Have 20% ETR



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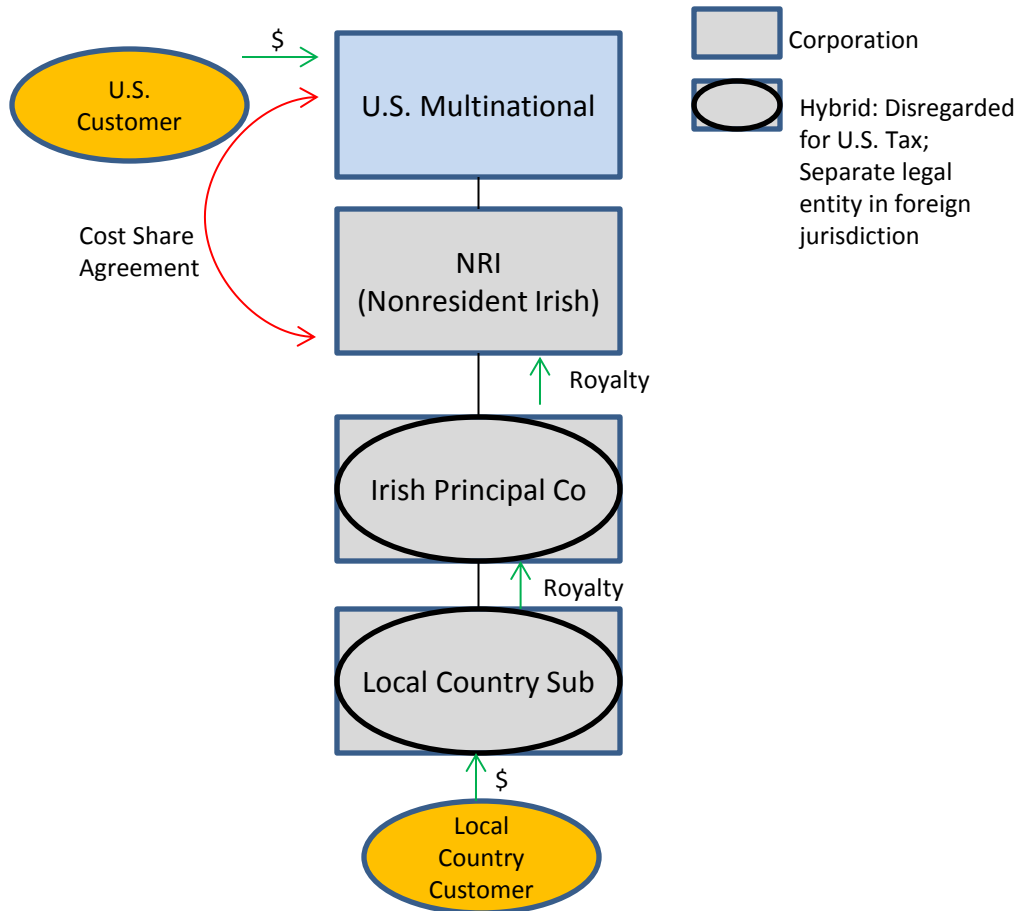
# How USMTN Pays 20% Tax

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- Basics of U.S. international tax planning
  - Taxation & income recognition:
    - U.S. corps. are taxable on worldwide income
    - When is income earned by a foreign subsidiary corporation recognized by a U.S. parent corporation?
      - When funds repatriated via a dividend (subject to exceptions)
      - Allows for “deferral” of U.S. income tax
  - Corporate tax residency
    - U.S. Rule - tax resident where incorporated
    - Irish Rule - tax resident where place of management
  - Check the box rules & hybrid entities



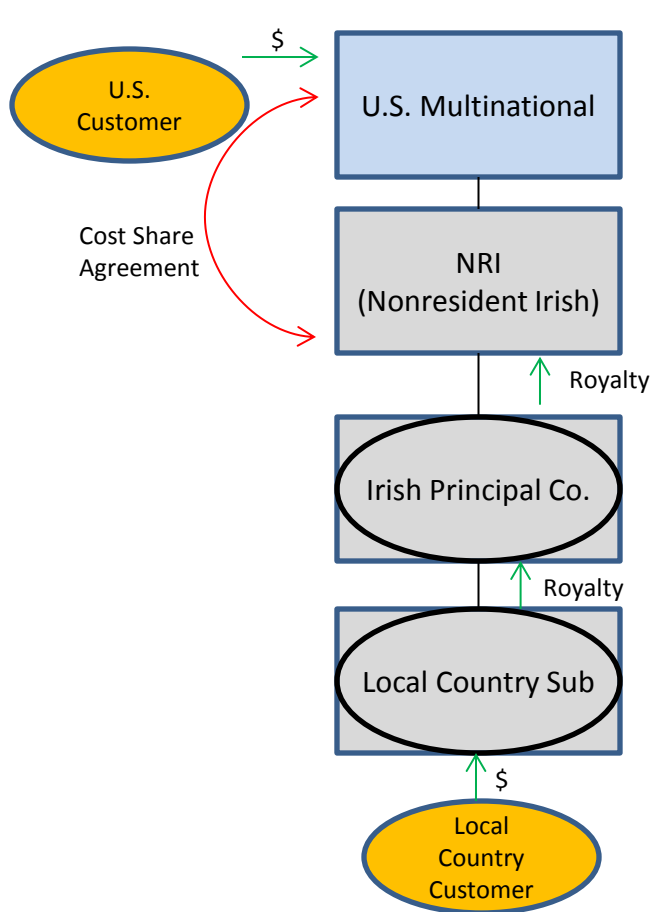
# How USMTN Pays 20% Tax



- U.S. Multinational owns NRI
  - NRI is Irish incorporated (i.e., treated as an Irish resident for U.S. tax purposes)
  - Managed in tax haven (i.e., treated as Tax Haven resident for Irish tax purposes)
- U.S. Multinational transfers non-U.S. IP rights to NRI via a Cost Share Agreement
- NRI makes an election under the check-the-box rules to treat subsidiaries as disregarded for U.S. tax purposes
- Subsidiaries pay royalty for use of IP to NRI.
  - Royalty payment is disregarded for U.S. tax purposes, but the deduction is allowed for local country tax purposes.



# How USMTN Pays 20% Tax



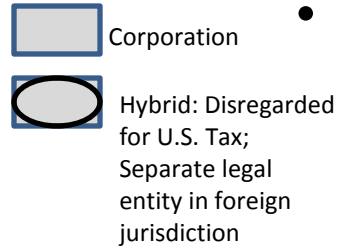
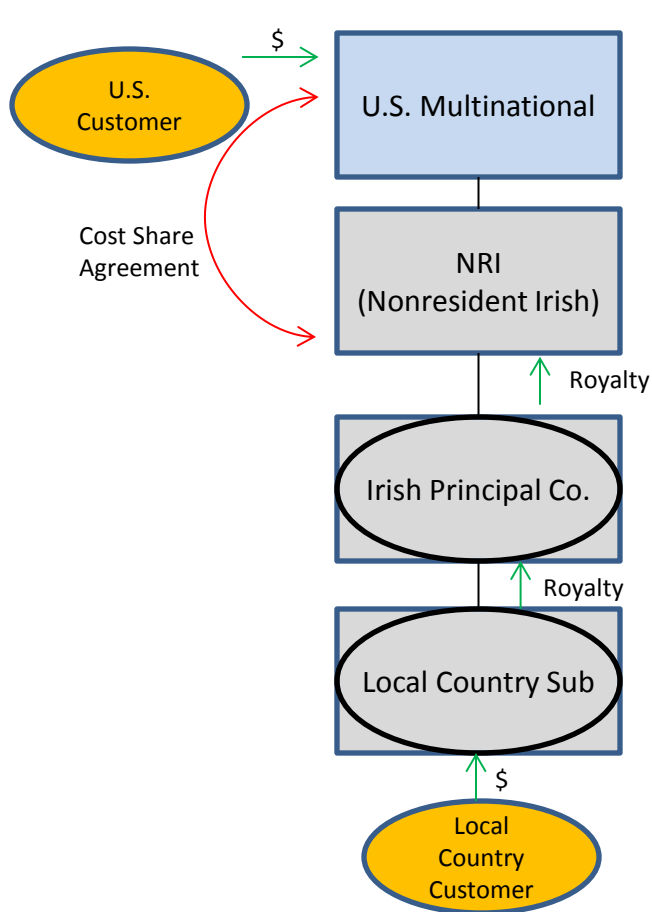
Corporation  
 Hybrid: Disregarded for U.S. Tax; Separate legal entity in foreign jurisdiction

- \$100 Worldwide Revenue
  - \$50 U.S.
  - \$50 ROW
    - Local Country Sub
      - Revenue of \$50
      - Expense of \$45 (royalty payment to Irish Principal Co.)
    - Irish Principal
      - Revenue of \$45
      - Expense of \$43 (royalty payment to NRI)
    - NRI
      - Revenue of \$43



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# How USMTN Pays 20% Tax



- **Taxable Income & Tax Liability**
  - **U.S.:**
    - Taxable Income = \$50
    - Tax = \$17.50 (\$50 \* 35%)
  - **Local Country Sub:**
    - Taxable Income = \$5.00
    - Tax = \$1.50 (\$5 \* 35%)
  - **Irish Principal Co.:**
    - Taxable Income = \$2
    - Tax = \$.25 (\$2 \* 12.5%)
  - **NRI:**
    - Taxable Income = \$43
    - Tax = \$0 (\$43 \* 0%)
- **Total: TI = \$100; Tax = \$19.25**
  - **Effective Tax Rate = 19.25%**



# How USMTN Pays 20% Tax

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- Apple's Corporate Tax
  - Apple's effective tax rate was ~20% in 2012
  - Apple is the largest corporate taxpayer in the U.S. – \$6B in 2012
- U.S. tax liability is deferred, not eliminated
  - Apple will pay U.S. corporate income tax if cash is repatriated
- Proposals to eliminate IP deferral planning
  - Tax currently “excess profits” from IP
  - End check-the-box rules
  - OECD base erosion proposals





# Overview

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- Residency
- Common issues & planning for U.S. Persons
- Common issues & planning for non-U.S. persons
- IC-DISC export tax incentive
- Expatriation
- Filing requirements & offshore voluntary disclosure



# **U.S. Tax Residency Rules: Income vs. Estate & Gift Tax**



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# Residence Test for Income Tax

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- Issue: *When is client a U.S. person for U.S. Income Tax purposes?*
  - **Individuals.** Sec. 7701(a)(30); Sec. 7701(b)(1).
    - a) U.S. Citizen,
    - b) Legal Permanent Resident (Green Card Holder), or
    - c) Substantial Presence Test.
  - **Corporations.** Sec. 7701(a)(30); Sec. 7701(a)(4).
    - Place of incorporation.
  - **Partnerships.** Sec. 7701(a)(30); Sec. 7701(a)(4).
    - Place of organization
      - » Treas. Reg. 1-861-2(a)(2); partnership is a U.S. “resident” if engaged in a U.S. trade or business.



# Residence Test for Income Tax

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- **Substantial Presence Test. Sec. 7701(b)(3)(A).**
  - a) Present in U.S. at least 31 days of current year; and
  - b) 183 aggregate days in U.S.
    - All days in tax year +
    - 1/3 of days in preceding year +
    - 1/6 during second preceding year.
  
- **Substantial Presence Test Rebutted? – the Closer Connection Test. Sec. 7701(b)(3)(B).**
  - a) In U.S. less than 183 days in tax year;
  - b) Tax home in foreign country for entire year; and
    - If eligible to deduct expenses for travel away from that foreign home
  - c) Has closer connection with foreign country than with U.S.
    - Facts & circumstances test: location of permanent home; family; belongings; location of social, political, cultural, and religious relationships, etc.



# Residence Test for Estate & Gift Tax

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- Issue: *When is an individual a U.S. resident for estate & gift transfer tax purposes?*
  - Client is a U.S. Resident if:
    - (1) U.S. citizen; or (2) domiciled in the U.S. Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b).
    - While statute uses term “resident”, it really contemplates domicile
    - Look at intent:
      - » A person acquires a domicile in a location by living there, even for a brief period, with “no definite present intention” of later removing from that location.
      - » Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile.
      - » If domicile exists in the United States, an intention to change domicile does not actually effect such a change unless accompanied by an actual removal from the U.S.



# Common Issues & Planning for U.S. Persons



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# Taxation of a U.S. Person

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- Income Tax
  - Taxable on Worldwide Income
- Estate Tax
  - Taxable on Worldwide Assets
- Foreign Tax Credit to Avoid Double Taxation



# U.S. Person – Foreign Investments

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- U.S. tax classification of a foreign entity
  - Issue: *What is the default U.S. tax classification of a foreign entity?*
    - If all members have limited liability, default classification is a corporation. Reg. Sec. 7701-3(b).
    - May elect alternate classification by filing a **Form 8832** (check-the-box rules). Reg. Sec. 7701-3(a).
    - Per Se Corporation
      - Reg. Sec. 301.7701-2(b)(8) provides list of “per se” corporations
      - Not eligible for check-the-box





# U.S. Shareholder of Foreign Corp.

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- Dividends received/sale of foreign stock
  - Issue #1: *What tax rate applies to dividend income received from foreign corporation, ordinary or qualified dividend rate (“QDI”)?*
    - Dividends are QDI only if: Sec. 1(h)(11)(C).
      - Comprehensive income tax treaty
      - Eligible for benefits under the treaty
  - Issue #2: *What tax rate applies to sale of foreign stock?*
    - *Typical capital asset rules should apply, however consider:*
      - Section 1248 – sale of foreign stock treated as deemed dividend to extent of accumulated E&P
      - Notice 2004-70 – deemed dividends eligible for qualified dividend rate



# U.S. Shareholder of Foreign Corp. (cont.)

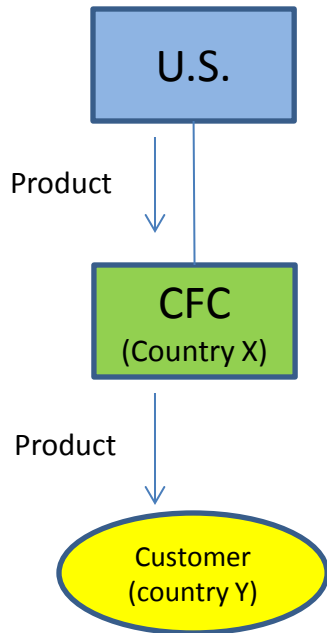
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- Subpart F Income
  - Issue #1: *Is the foreign corporation a CFC?*
    - CFC if: U.S. Shareholders own more than 50% of vote or value. Sec. 957
    - U.S. Shareholder if: U.S. person with 10% or more of vote. Sec. 951(b).
  - Issue #2: *Is there Subpart F income?*
    - Foreign Personal Holding Company. Sec. 954(c).
      - Passive income such as dividends, interest, royalties, etc.
    - Foreign Base Company Sales Income. Sec. 954(d).
      - Purchase or sale of property that is: (1) manufactured, produced, extracted outside the country where the CFC is incorporated, and (2) sold outside the country where CFC incorporated.
    - Foreign Base Company Services Income. Sec. 954(e).
      - Services performed: (1) for or on behalf of related party; (2) outside of CFC country of incorporation.
    - Investment of CFC earnings in US property. Sec. 956.

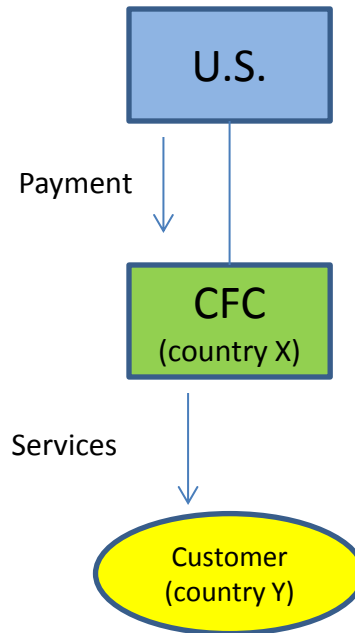


# U.S. Shareholder of Foreign Corp (cont.)

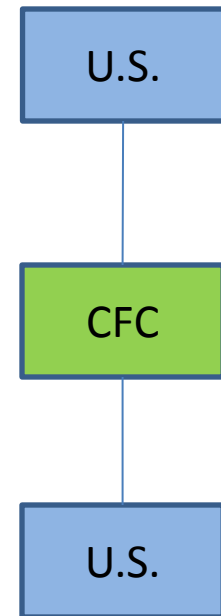
## Foreign Base Company Sales



## Foreign Base Company Services



## Investment in U.S. Property



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# U.S. Shareholder of Foreign Corp. (cont.)

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- Subpart F Income

- Issue #3: *Does an exception to Sub F apply?*

- High tax exception – effective tax rate of CFC at 90% of max U.S. corporate tax rate (31.5%). Sec. 954(b)(4).
    - *De minimis* rule - FBCI is less than: Sec. 954(b)(3).
      - 5% of gross income; and
      - \$1M

- Planning out of CFC status

- 11 or more equal investors



# U.S. Shareholder of Foreign Corp. (cont.)

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- Passive Foreign Investment Company (“PFIC”)
  - Issue #1: *Is foreign stock investment a PFIC?* Sec. 1297(a).
    - **Income Test**: 75% or more of income from passive sources; or
    - **Asset Test**: 50% or more of assets produce passive income
  - Issue #2: *What is “passive” under the PFIC Test?* Sec. 1297(b); Sec. 954(c).
    - Passive defined as Foreign Personal Holding Company Income
    - Cash is deemed a “passive” asset in determining PFIC status
  - Issue #3: *How is a PFIC taxed?*
    - Excess Distribution – Sec. 1291
    - Qualified Electing Fund (QEF) – Sec. 1295
    - Mark to market – Sec. 1296
  - Issue #4: *Has the fund been a PFIC?* Once a PFIC always a PFIC. Sec. 1298(b).



# Noncitizen Spouse

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- Qualified Domestic Trust (“QDOT”)
  - Issue: *Is the client’s spouse not a U.S. citizen?*
    - Sec. 2056 generally allows tax free transfer to surviving spouse
    - Sec. 2056 does not apply if surviving spouse is not a U.S. Citizen.
    - Exception – Tax free transfer allowed if property passes to a Qualified Domestic Trust (“QDOT”).



# Noncitizen Spouse (cont.)

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- QDOT Requirements:
  - a) At least one trustee must be an individual citizen of the U.S. or a domestic corporation; and
  - b) No distribution (other than income) be made unless the trustee who is a citizen of the U.S. or a domestic corporation has the right to withhold from the distribution the tax on distributions imposed by IRC § 2056A.
- Taxable Distributions:
  - Any distribution from a QDOT made before the death of the surviving spouse and any property remaining in a QDOT at the time of the death of the surviving spouse is subject to an estate tax at the marginal rate applicable to the estate of the deceased spouse who created the trust.



# Foreign Tax Credit

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- Issue: *Is a taxpayer liable for tax in both the U.S. and a foreign jurisdiction?*
  - Foreign Tax Credits may allow the taxpayer to avoid double taxation
- Foreign Income Tax Credit:
  - Sec. 901 - credit on foreign income taxes paid directly by U.S. person
  - Sec. 902 - credit on foreign income taxes paid by foreign corporation and 10% or greater U.S. corporate shareholder
  - Sec. 903 - credit for foreign taxes paid “in lieu of” income
- Foreign Estate Tax Credit:
  - Sec. 2014 allows estate tax credit for foreign estate taxes paid





# International Tax Issues for Nonresidents



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# U.S. Tax Regime Basics – Nonresident

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- U.S. Taxation of Nonresidents
  - Issue #1: When is a nonresident subject to U.S. income tax?
    - Generally, U.S. income tax liability if:
      - Services performed within the U.S.
      - Business activities within the U.S.
        - » U.S. source income that is effectively connected income (“ECI”) with U.S. trade or business
      - Investment income from U.S.
        - » U.S. source fixed, determinable, annual, periodic (“FDAP”) income
        - » 30% withholding tax on interest, dividends, rents, etc.
  - Issue #2: Is a nonresident subject to U.S. estate and gift transfer tax?
    - Estate Tax: gross estate of nonresident consists of only property situated in the U.S.
    - Gift Tax: Transfer of U.S. real property or tangible personal property situated in the U.S.; No U.S. gift tax for transfers of intangible property. Sec. 2501(b)(2).



# Nonresident – U.S. Real Property

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- Issue: *Does the nonresident client own a U.S. real property interest?*
  - Foreign Investment in Real Property Tax Act (“FIRPTA”):
    - Nonresident taxable on gain from sale of USRP interest. Sec. 897; Sec. 871(b).
    - Enforcement Mechanism: 10% withholding required by buyer when purchasing USRP from nonresident seller. Sec. 1445.
  - Rental Income:
    - Subject to 30% withholding tax if not effectively connected with US trade or business. Sec. 1441; Sec. 1442.
    - May elect to be taxed on net basis. Sec. 871(d).



# Nonresident – U.S. Real Property

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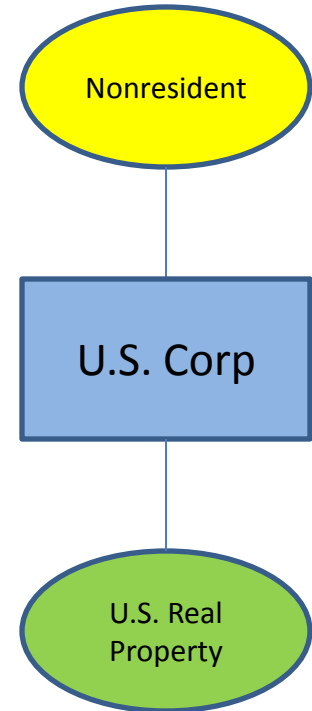
- U.S. Holding Company

- Pros:

- Liability protection
    - Nonresident owner not required to file U.S. returns (U.S. Corp files)
    - No FIRPTA withholding if U.S. Corp sells U.S. Real Property
    - Gift of stock in U.S. Corp not subject to U.S. gift tax

- Cons:

- Double taxation (tax at corporate level & potential withholding tax on dividends if no treaty)
    - Nonresident's gross estate will include value of stock at time of death under Sec. 2014(a).
    - At sale of U.S. Corp stock FIRPTA withholding applies if 50% of assets consists of U.S. Real Property
    - Create separate legal entity, and comply with corporate formalities.



# Nonresident – U.S. Real Property

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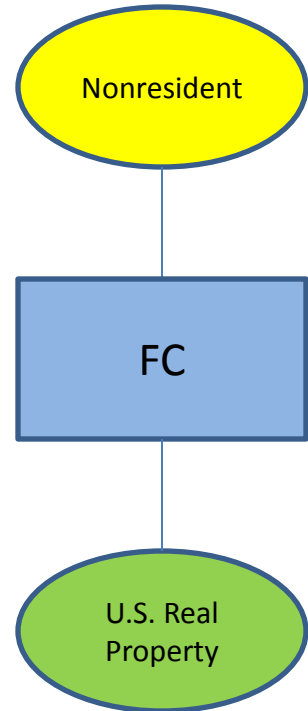
- **Foreign Holding Company**

- **Pros:**

- Liability protection
- Nonresident owner not required to file U.S. returns (FC files)
- No FIRPTA withholding when sell FC stock
- No U.S. Gift or Estate tax

- **Cons:**

- FIRPTA withholding if FC sells U.S. real property.
- Risk that branch profits tax applies at 30% of “dividend equivalent amount”.
- Create separate legal entity, and comply with corporate formalities.



# Nonresident – U.S. Real Property

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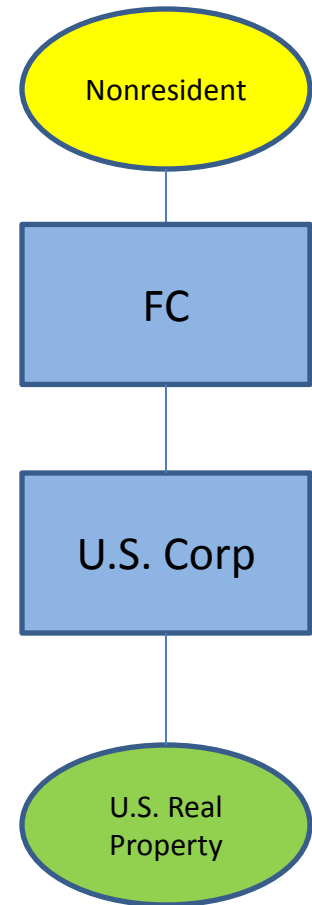
- Two-tier holding structure

- Pros:

- Liability protection
    - Nonresident owner not required to file U.S. returns (U.S. Corp files)
    - No branch profits tax
    - No FIRPTA withholding when U.S. Corp. sells U.S. real property and liquidates.
    - No U.S. tax on distributions from FC
    - No U.S. gift tax on transfer of FC, FC not included in gross estate at death

- Cons:

- Requires creation and maintenance of two separate legal entities.
    - If FC ever sells U.S. Corp. shares, subject to FIRPTA withholding



# Export Tax Incentive: IC-DISC



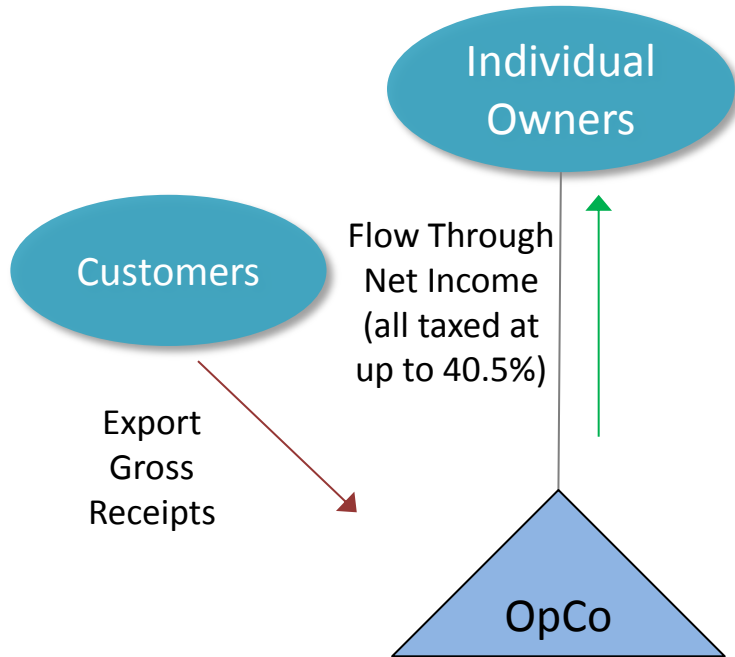
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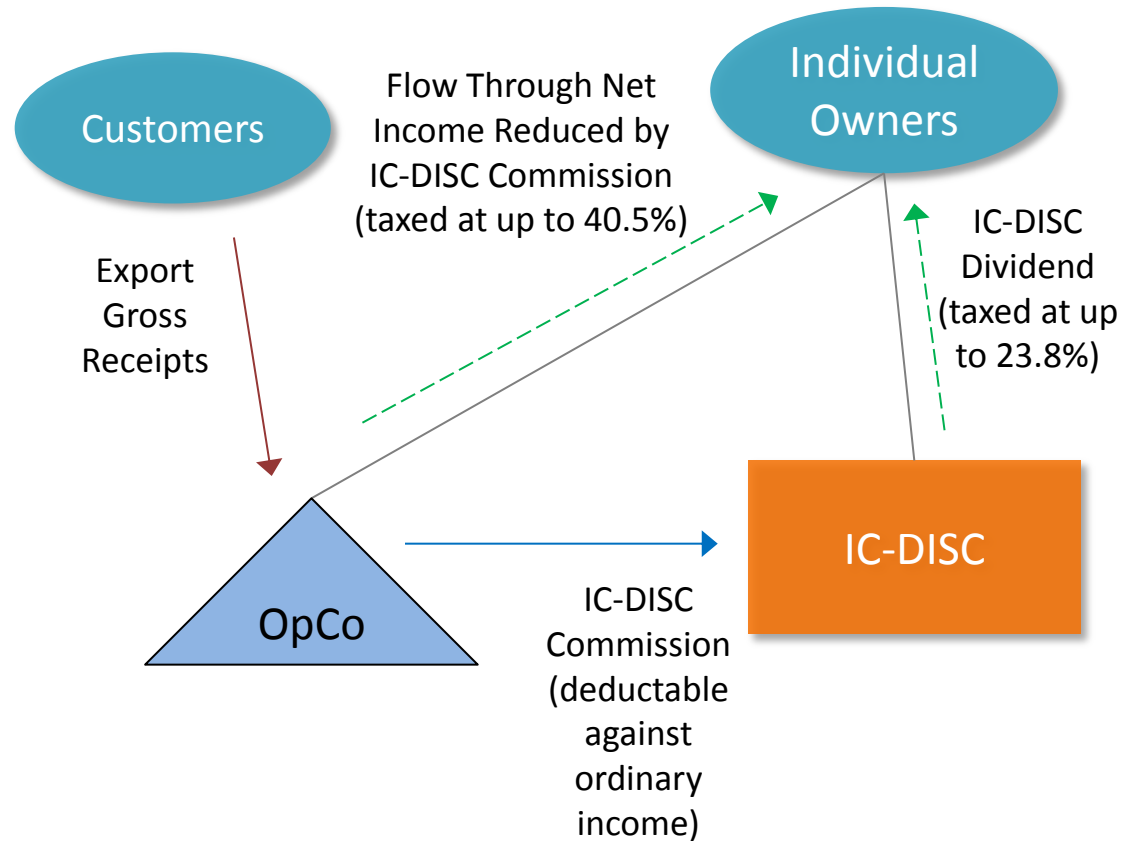
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# Example of an IC-Disc Structure

## Without IC-DISC



## With IC-DISC





# IC-DISC Benefits

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Amounts paid by an operating company to its related IC-DISC (usually commissions) are deductible to the operating company. An IC-DISC generally does not pay corporate income tax on its income. This yields two primary benefits:

- 1) Lower Tax Rate:** Companies without an IC-DISC realize income at ordinary rates, currently up to 40.5% (35% for corporations). Income permitted to flow through the IC-DISC reduces the income taxed at these rates, and such income is not taxed in the hands of the IC-DISC. When the IC-DISC distributes earnings to the shareholders, they represent dividend income, which may be taxable at qualified rates (currently 15% - 23.8%).
- 2) Tax Deferral-** An IC-DISC is permitted to retain earnings attributable to the first \$10,000,000 of gross receipts, deferring taxation to its shareholders. An interest charge is imposed on the deferred tax amounts, and the rate is determined by the “base period T-bill rate” (currently a fraction of a percent). This amounts to a low interest loan from the government in the amount of the deferred tax liability, and may be an attractive borrowing option in the current low-interest rate environment. Funds retained by an IC-DISC may generally be loaned back to the related business (subject to conditions which require careful monitoring).



# Calculating IC-DISC Commissions

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Although an IC-DISC may be structured as purely a paper corporation, the tax laws allow the related business (owned by the same shareholders) to pay the IC-DISC a deductible commission each year.

Two general methods for determining the IC-DISC's commission are allowed:

- 1) The **4 percent of qualified export receipts** method:
  - Under this method, the commission payable to the IC-DISC may be up to 4 percent of the related taxpayer's gross "qualified export receipts".
- 2) The **50 percent of combined export taxable income** method:
  - Under this method, the commission payable to the IC-DISC may be up to 50 percent of the taxable income realized by the taxpayer on "qualified export receipts." In determining the taxable income, expenses of the taxpayer must be allocated and apportioned between export and non-export receipts based upon special international tax apportionment rules.



# IC-DISC Rate Benefits Comparison

| Without IC-DISC                      |                  |
|--------------------------------------|------------------|
| Total Gross Export Receipts          | 10,000,000       |
| Allocated Direct & Indirect Expenses | 8,000,000        |
| Taxable Income                       | 2,000,000        |
| <b>Partners' Marginal Tax Rate</b>   |                  |
|                                      | 40.5%            |
| <b>Total Tax Paid</b>                | <b>810,000</b>   |
| <b>Net Cash Flow</b>                 | <b>1,190,000</b> |

**Note:** Rates are estimates and include newly instituted Medicare taxes. The applicable rates may vary based on a taxpayer's individual circumstances.

\* Actual IC-DISC commissions may be greater through the application of transaction by transaction analysis

\*\* Payment of these taxes can be deferred, subject to an interest charge.

| With IC-DISC  |                  |
|---|------------------|
| Total Gross Export Receipts   | 10,000,000       |
| Allocated Direct & Indirect Expenses                                      | 8,000,000        |
| Taxable Income  | 2,000,000        |
| <b>Commission - 4% of Gross Receipts Method</b>                           |                  |
|   | 400,000          |
| <b>Commission - 50% of Combined Taxable Income Method</b>                 |                  |
|   | 1,000,000*       |
| <b>Maximum Estimated Commission</b>                                       |                  |
|   | 1,000,000        |
| <b>Applicable Tax Rate</b>  |                  |
|   | 40.5%            |
| <b>Taxable Income subject to 40.5% tax rate (1M minus 500K deduction)</b> |                  |
|   | 1,000,000        |
| <b>Tax paid at 40.5% rate</b>   |                  |
|   | 405,000          |
| <b>Qualified Dividend Rate</b>  |                  |
|   | 23.8%            |
| <b>Commission Amount subject to 23.8% tax rate</b>                        |                  |
|   | 1,000,000        |
| <b>Tax paid at 23.8% rate</b>   |                  |
|   | 238,000**        |
| <b>Total Tax Paid</b>   | <b>643,000</b>   |
| <b>Net Cash Flow</b>  | <b>1,357,000</b> |
| <b>Estimated Net Cash Benefit from IC-DISC</b>                            | <b>167,000</b>   |



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# Expatriation



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# Expatriation Tax

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- Issue #1: *When does the expatriation tax apply?*
  - **Expatriate**
    - U.S. citizen relinquishes citizenship; or
    - Long Term Permanent Resident (Green Card Holder in 8 of previous 15 years) terminates residency.
  - **Covered Expatriate**
    - a) Tax liability test: Average net tax liability of previous 5 years of \$124K or more;
    - b) Net worth test: Net worth of \$2M or more; or
    - c) Fails to certify that has complied with all federal income tax obligations for preceding 5 years (File Form 8854).



# Expatriation Tax

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- Issue #2: *How is the client taxed?*
  - Taxable under mark-to-market regime
  - Treated as if expatriate sold all property on day prior to expatriation
  - Taxable to extent net gain exceeds \$600K



# International Filing Requirements, FATCA and the OVDP



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# Filing Requirements

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- Common International Filing Requirements:
  - **TD F 90-22.1** – Foreign Bank Account Reporting (“FBAR”)
  - **Form 5471** – Information Filing with Respect to Certain Foreign Corporations
  - **Form 8621** – Information return for shareholder of PFIC
  - **Form 3520, Form 3520A** – Foreign Trusts & Receipt of Certain Foreign Gifts
  - **Form 8865** - Foreign partnership
  - **Form 8858** - Foreign DRE (e.g., single member LLC)
  - **Form 8938** - Foreign Account Tax Compliance Act (“FATCA”)





# Potential Penalties for Failing to File

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- Penalties:
  - Potential \$100,000/ \$10,000 penalty
- Accuracy Related Penalty for Underpayment of Tax
- Potential to toll statute of limitations
- Potential criminal prosecution



# FATCA

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- Part of 2010 HIRE Act
- Two Parts:
  1. New Filing Requirement if Specified Foreign Financial Assets exceed threshold
    - Filing threshold: taxpayer living in the US
      - *Files Unmarried, Married Filing Separately*: Value of assets greater than \$50,000 on the last day of the tax year or greater than \$75,000 on any day during the year
      - *Files Married Filing Jointly*: Value of assets greater than \$100,000 on the last day of the tax year or greater than \$150,000 on any day during the tax year
    - Filing threshold: taxpayer living abroad
      - *Files Unmarried, Married Filing Separately*: Value of assets is greater than \$200,000 on the last day of the tax year or greater than \$300,000 on any day during the tax year
      - *Files Married Filing Jointly*: Value of assets is greater than \$400,000 on the last day of the tax year or greater than \$600,000 on any day during the tax year
    - Filing in addition to other filing requirements (i.e., must still file FBAR)
  2. U.S. Government Agreements with Foreign Countries



# Offshore Voluntary Disclosure Program

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- Program in third iteration
  - 2009 & 2011 programs closed, raised \$5.5B of additional tax revenue
- **Benefits:**
  - Potential criminal amnesty
  - Ability to become tax compliant
  - Avoid certain penalties
- Generally, ineligible if I.R.S. obtains foreign account information prior to coming forward.



# Contact Information

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