

International Tax Primer



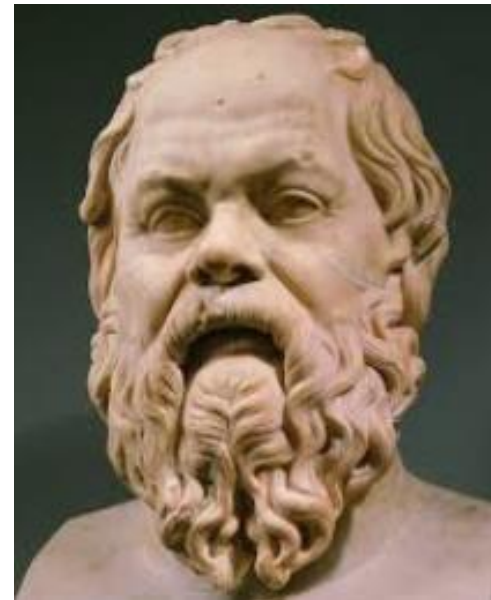
Overview

1. Where to Start
2. General Principles
3. Residency
4. Direct offshore activity
5. Investment in Foreign Corporation
6. Controlled Foreign Corporation
7. Passive Foreign Investment Company
8. Investment in Foreign Partnership



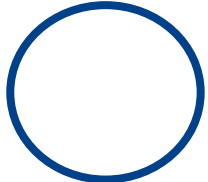
Where to Start?

- “To know thy client/taxpayer is the beginning of International Tax wisdom”
 - Socrates





Global Org Chart



Individual



Branch



Corporation for U.S. and local tax purposes



Corporation for U.S. tax purposes,
Partnership for local tax purposes



Disregarded entity for U.S. tax purposes,
Corporation for local tax purposes



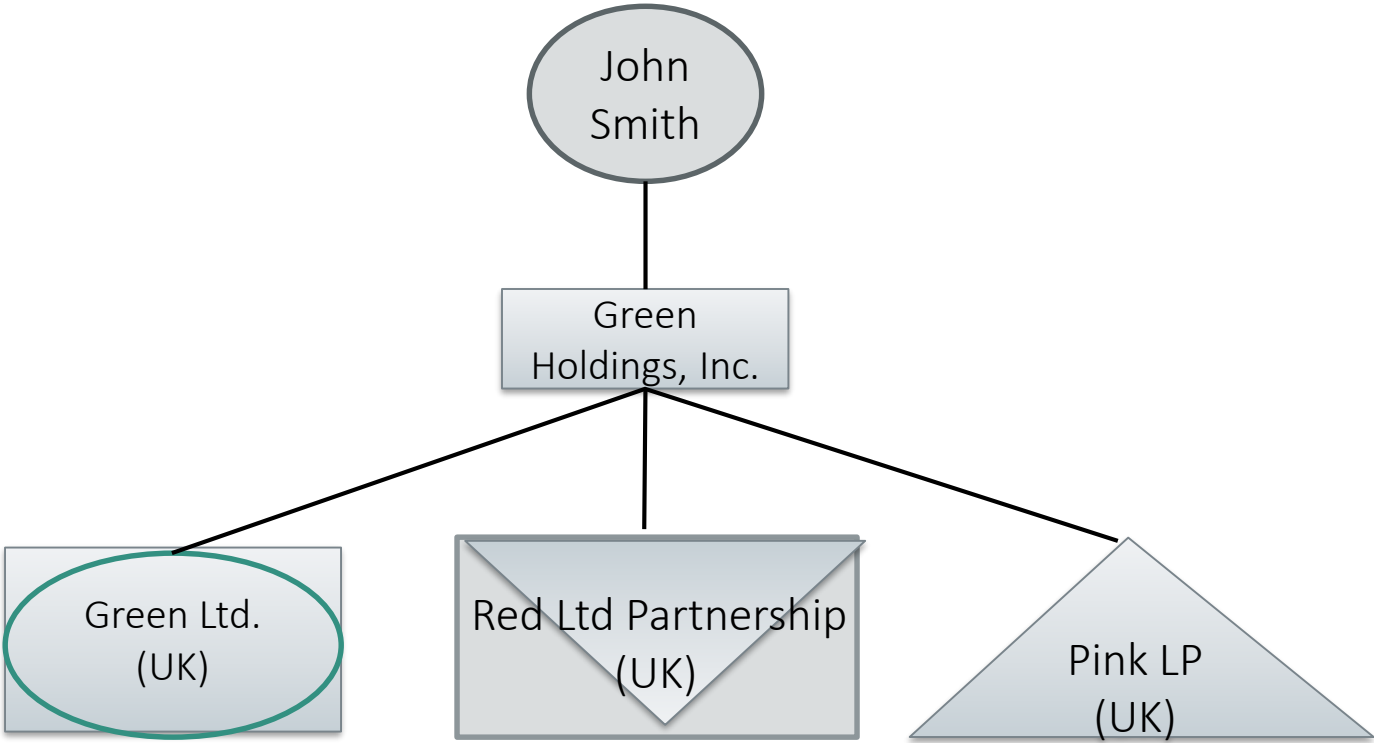
Partnership for U.S. tax purposes,
Corporation for local tax purposes



Partnership for U.S. tax purposes Partnership for
local tax purposes

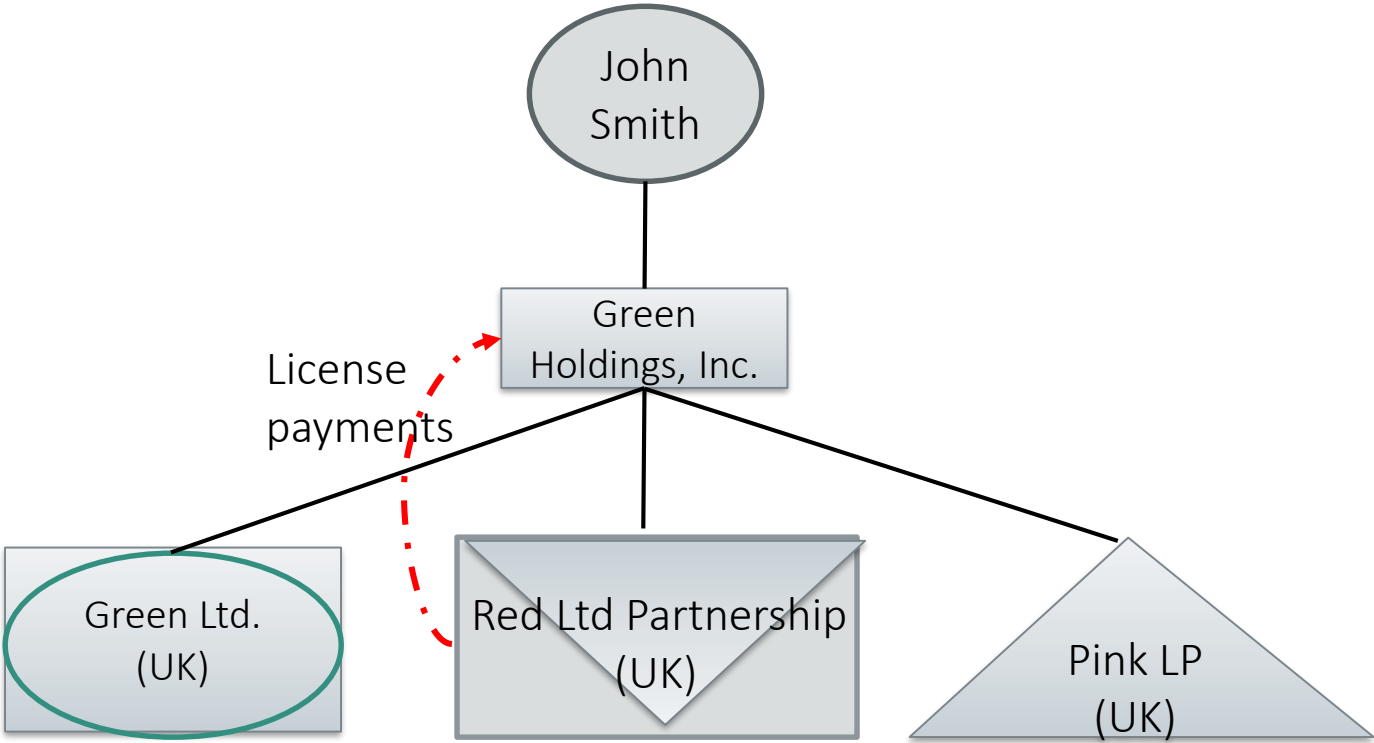


Global Org Chart - Example





Global Org Chart - Example





Three Main Goals

1. Understand if there is any impact on taxable income

2. Identify filing requirements



3. Identify if there are any planning opportunities



General Principles

U.S. Persons

- Subject to U.S. income tax on their worldwide income



Foreign Persons

- Generally subject to U.S. income tax only on certain U.S. source income





Who is a U.S. Person?

- An individual is a resident for all federal tax purposes for a particular year if the individual:
 - Is a citizen or Green Card holder
 - meets the “substantial presence test” for the year, or
 - qualifies for and makes the “first year election” for the year. (§ 7701(b)(1))



Who is a U.S. Person (cont.)?

- A corporation/partnership is considered “domestic” or a resident if it is created or organized in the United States (50 states or D.C.). (§7701(a)(4)) or elect under §1504(d)
- Trust is considered “domestic” if the trust instrument is governed by a US court and majority of the trustees are US individuals



Polling Question #1



What Types of Investments

- Direct activity
- Investment in foreign corporation
- Investment in foreign partnership



Direct Activity

- Income from direct activity subject to tax as earned
- Potential filings:
 - Form 8858 – Information Return of US Persons With Respect to Foreign Disregarded Entity or Foreign Branch
- Planning Opportunities – Limited



Investment in Foreign Corporation

- General Rule
- Controlled Foreign Corporation (CFC)
- Passive Foreign Investment Company (PFIC)



General Rule

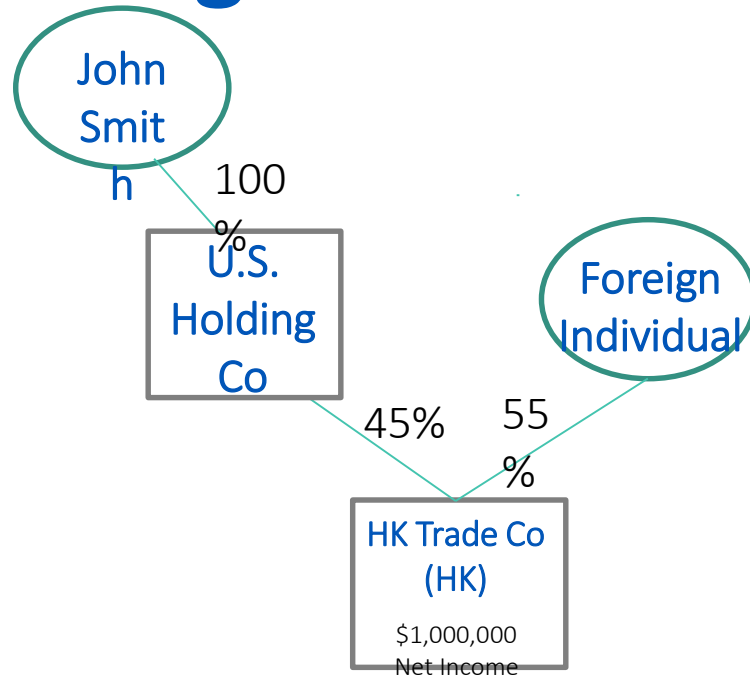
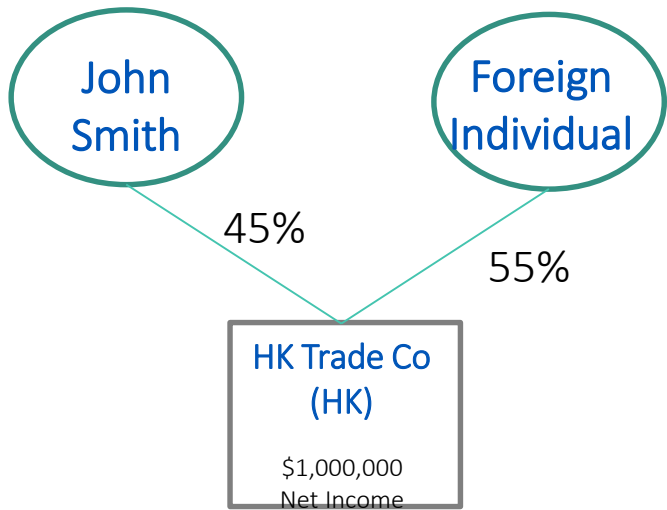
- Generally if a US person owns stock in a foreign corporation the income generated in the foreign corporation is taxed in the local country and not taxed in the US until repatriated
- Upon repatriation it is dividend income and maybe qualified dividend income if it is paid by an entity that qualifies for benefits from an income tax treaty



General Rule – Filing Requirements

- Filing Requirements:
 - Form 926 Return of U.S. Transferor of Property to a Foreign Corporation
 - Form 5471 Information Return of U.S. Persons with Respect to Certain Foreign Corporations
 - Form 8938 Statement of Specified Foreign Assets
 - Fin Cen 114 Report of Foreign Bank and Financial Account (FBAR)

General Rule – Planning



- Net Income of \$1,000,000 taxed at 16.5% HK corporate rate
- Distribution to John Smith taxed at the ordinary rate of 37% with no foreign tax credit.
- **Worldwide tax paid on income \$473,950**

- Net Income of \$1,000,000 taxed at 16.5% HK corporate rate
- Distribution to U.S. Holding Co Inc. is exempt from U.S. corporate tax by virtue of a 100% Dividend Received Deduction (DRD)
- Distribution to John Smith taxed as qualified dividend rate 23.8%
- **Worldwide tax paid on income \$363,730**



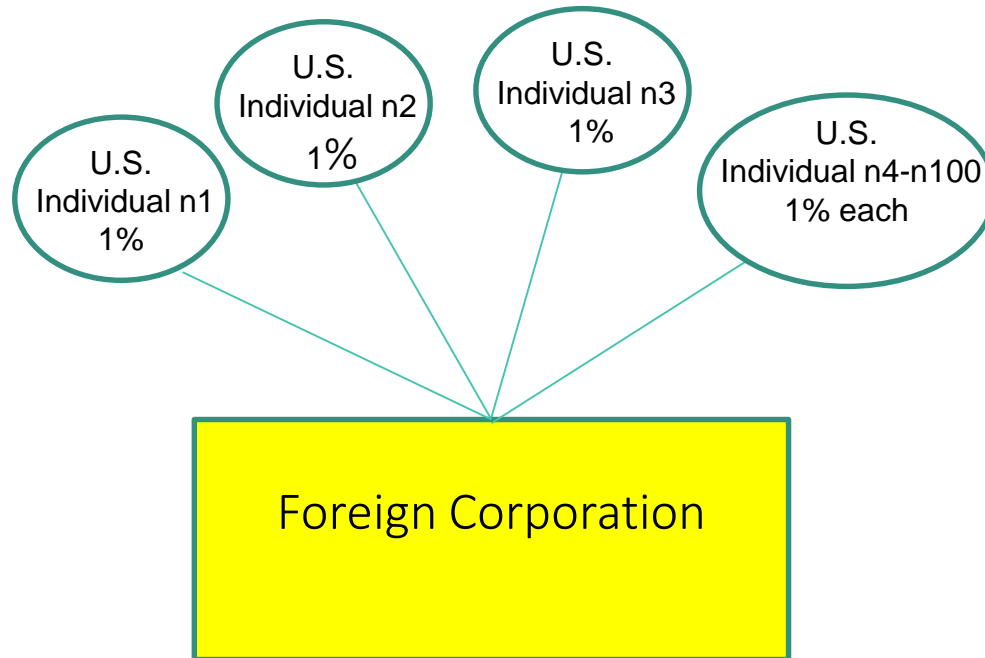
What is a CFC?

- A Controlled Foreign Corporation (CFC) is a foreign corporation that is owned more than 50% (vote or value) by U.S. Shareholders
- U.S. Shareholders are U.S. persons that own 10% or more of the stock (vote or value) in a foreign corporation

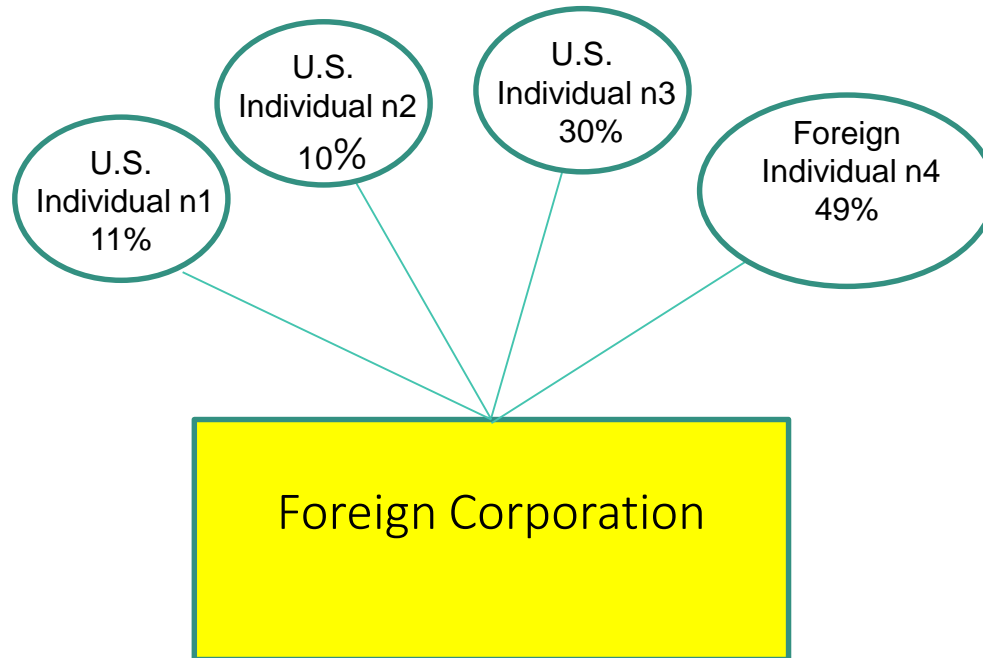


Polling Question #2

What is a CFC?



What is a CFC?





What is the impact of being a U.S. Shareholder of a CFC?

- Shareholders in CFCs will be subject to the anti deferral regimes:
 - Subpart F- different types of income would be considered Subpart F such as:
 - Passive income – rents, royalties, dividends, interest
 - Sale of product where there was a related party transaction involved
 - Provision of services where there is a related party transaction involved
 - Global Intangible Low Taxed Income (GILTI) – any income of a CFC that exceeds 10% of its fixed assets
 - Section 956 – Loans to US shareholders, investment in US assets, or using the CFC as collateral on U.S. Shareholder loan from bank



Impact to U.S. Shareholder of CFC (cont.)

- These inclusions are generally taxed as ordinary income to individual shareholder and there is no foreign tax credit available
- For C Corp shareholder there is a foreign tax credit available generally and in addition 50% deduction available for GILTI income to C Corps



Polling Question #3



Filing requirements for CFC

- Filing Requirements:
 - Form 926 Return of U.S. Transferor of Property to a Foreign Corporation
 - Form 5471 Information Return of U.S. Persons with Respect to Certain Foreign Corporations
 - Form 8938 Statement of Specified Foreign Assets
 - Fin Cen 114 Report of Foreign Bank and Financial Account (FBAR)



Planning Opportunities for CFC

- Individual U.S. Shareholder of CFC should consider restructuring to avoid impact of GILTI
- Other options include Section 962 election or High tax exception
- Check the Box Election
- Transfer Pricing should also be considered



What is a PFIC?

- A Passive Foreign Investment Company is a foreign corporation if more than 50% of its assets are held to generate passive income or more than 75% of its income is passive type income.
- Passive income is generally rents, royalties, dividends, interest, capital gains
- U.S. person would be considered shareholder in PFIC at any ownership level even .05% of ownership



What is a PFIC (cont.)?

- Common type of PFIC investment is foreign mutual fund

What is impact of owning shares in a PFIC?

- Excess Distribution Regime
 - Upon receipt of distribution or disposition of stock treat the income as though it was earned ratably over the holding period of the stock
 - Taxed at the highest ordinary rate regardless of taxpayer's bracket
 - Interest charge for amount of tax “deferred”





Polling Question #4

What is impact of owning shares in a PFIC (cont.)?

- QEF election
- Mark to Market Election





PFIC – Filing Requirements

- Form 926 Return of U.S. Transferor of Property to a Foreign Corporation
- Form 8621 Information Return by a Shareholder of a PFIC or QEF



US Partner in Foreign Partnership

- Any U.S. person's investment in an entity that is considered a foreign partnership for U.S. tax purposes (note importance of entity classification rule)
- Treated similar to investment in domestic partnership – flow-through treatment

Foreign Partnership – Filing Requirements

- Form 8865 Return of U.S. Persons with Respect to Certain Foreign Partnerships
- Form 8938 Statement of Specified Foreign Assets
- Fin Cen 114 Report of Foreign Bank and Financial Account (FBAR)





Foreign Partnership - Planning

- Check the Box Election

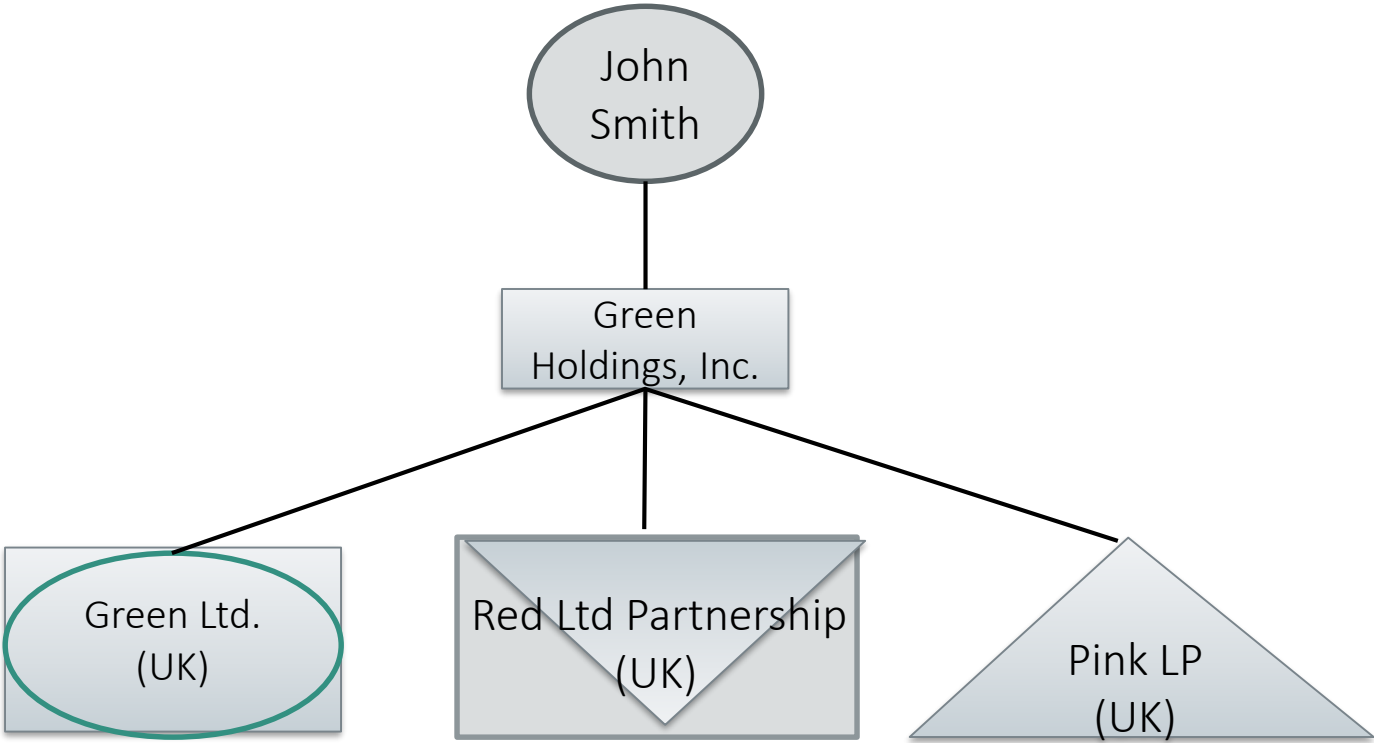


General Planning

- Entity Classification / Check the Box Election
- Foreign Tax Credit Considerations

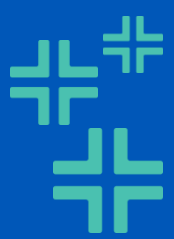


Global Org Chart - Example





Questions





Disclaimer

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