

Foreign Investment in U.S. Real Property: Taxation and Reporting Considerations

Anticipating Tax Issues When a Foreign Investor or Entity Acquires or Disposes of Interests

THURSDAY, JULY 11, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Amy P. Jetel, Partner, **Beckett Tackett & Jetel**, Austin, Texas

Jim Lokey, Partner, **King & Spalding**, Atlanta

Daniel Kolb, Partner, **Ropes & Gray**, New York

For this program, attendees must listen to the audio over the telephone.

Please refer to the instructions emailed to the registrant for the dial-in information. Attendees can still view the presentation slides online. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Tips for Optimal Quality

Sound Quality

Call in on the telephone by dialing 1-866-873-1442 and enter your PIN when prompted.

If you have any difficulties during the call, press *0 for assistance. You may also send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

Attendees must stay on the line throughout the program, including the Q & A session, in order to qualify for full continuing education credits. Strafford is required to monitor attendance.

Record verification codes presented throughout the seminar. If you have not printed out the "Official Record of Attendance," please print it now (see "Handouts" tab in "Conference Materials" box on left-hand side of your computer screen). To earn Continuing Education credits, you must write down the verification codes in the corresponding spaces found on the Official Record of Attendance form.

Please refer to the instructions emailed to the registrant for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Program Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides and the Official Record of Attendance for today's program.
- Double-click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Foreign Investment in U.S. Real Property: Taxation and Reporting Considerations

July 11, 2013

Amy Jetel, Beckett Tackett & Jetel
ajetel@btjlaw.com

Daniel Kolb, Ropes & Gray
Daniel.Kolb@ropesgray.com

Jim Lokey, King & Spalding
JLokey@KSLAW.com

Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Overview of U.S. Planning for Non-U.S. Investors

- Understand the client's situation and objectives
- Determine home country taxation
- Know the basic U.S. income tax rules
- If the investor is an individual, know the basic U.S. estate and gift tax rules
- Identify whether a treaty applies
- Analyze different ownership structures to meet the client's goals

Identify Client-Specific Facts

- Understand investor characteristics
 - Type
 - Location
 - Appetite for complexity
 - Single investor versus multiple investors
- How will the property be used?
 - Personal
 - Business
 - Investment
- What types of income will the property generate?
 - Rent
 - Interest
 - Dividends
 - Capital gains
 - Service
- How will the purchase be funded?
 - Equity
 - Debt
- What is the exit plan?

Identify Client's Objectives

- Tax objectives
 - Avoiding cross-border double taxation
 - Mitigating taxation of operating income
 - Obtaining long-term capital gains treatment on sale
 - Avoiding gift and estate taxes (for individual investors)
 - Limiting over-withholding
 - Limiting personal contact with U.S. tax system
- Non-tax objectives
 - Preserving confidentiality
 - Facilitating intra-family transfers (for individual investors)
 - Achieving limited liability

Home Country Taxation

- No planning should be undertaken before considering whether home country taxation is relevant
 - Typical planning vehicles for U.S. persons can be disastrous to a nonresident alien individual (for example, a transfer to a revocable trust by a U.K. resident will trigger immediate IHT)
 - Tax counsel in the other jurisdiction is essential
- If no treaty applies, tax credits or other adjustments may be available when two countries tax the same income

Treaty Analysis

- U.S. taxation of foreign investors may be modified by treaty
 - No exception from U.S. taxation of gain from real estate, but treaties can reduce or eliminate tax on interest and dividends
 - Almost all treaties contain “limitation on benefits” provision to counteract abuse
- Treaty analysis first requires an understanding of whether each country considers the client to be resident in that country under its internal rules
 - Again, tax counsel in the other jurisdiction is essential to understand home country taxation

Income Tax Treaties & Estate and Gift Tax Treaties

- The U.S. is party to more than 50 income tax treaties, but only 16 estate and gift tax treaties (because many countries do not have an estate, inheritance, or gift tax)
- Below are the countries with which the U.S. is party to estate and gift tax treaties:
 - Australia
 - Austria
 - Canada
 - Denmark
 - Finland
 - France
 - Germany
 - Greece
 - Ireland
 - Italy
 - Japan
 - Netherlands
 - Norway
 - South Africa
 - Switzerland
 - United Kingdom

Basic Income Tax Rules

U.S. Income Tax Residency

- **Objective Test for Individuals**
 - **U.S. Taxpayer:**
 - Citizenship
 - Green card
 - Substantial presence test
 - **Exceptions:**
 - Closer connection
 - Treaty-based position
 - Certain exempt individuals (e.g., foreign students, scholars, government employees)
 - **Consequences:**
 - Worldwide income taxation
 - Informational reporting requirements
- **Place of incorporation is touchstone for corporations**
 - The location of management and corporate decision making can also be critical to the tax analysis

Different Types of Income Taxed Differently

- Non-U.S. persons subject to U.S. tax on most U.S.-source income
- Gains – FIRPTA
 - Taxed by way of withholding on gross sales proceeds as a pre-payment of actual tax that will be due
- Business (“Effectively Connected”) Income
 - Taxed on net basis, as a U.S. person would be
- Passive (“FDAP”) Income
 - Taxed by way of withholding on gross income

FIRPTA: Taxation of Sales of Real Property

- Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) – § 897
- FIRPTA is the exception to the general rule that non-resident aliens are not subject to tax on gains from the sale of U.S. property

FIRPTA: Taxation of Sales of Real Property (cont'd.)

- Pursuant to § 897, gain (or loss) from sale or exchange of “United States real property interest” (“USRPI”) taxed under § 871 (for individuals) and § 882 (for corporations) as if foreign seller was engaged in the conduct of a trade or business in the U.S. and the gain (or loss) was effectively connected with such trade or business
- Therefore, foreign sellers are taxed on gains at the same rates applicable to U.S. sellers, and such gain can qualify for long-term capital gains treatment in the hands of a foreign individual

FIRPTA: Taxation of Sales of Real Property (cont'd.)

- Nonrecognition provisions (e.g., § 1031) do not apply unless the seller exchanges the USRPI for property that would itself be taxable in a subsequent sale or exchange
- Even though a REIT is a corporation for most purposes, § 897 applies a sort of pass-through regime with respect to distributions by a REIT to the extent attributable to gains from sales of USRPIs by the REIT

FIRPTA: U.S. Real Property Interest

- Definition of USRPI (Treas. Reg. § 1.897-1)
 - Interest in U.S. or U.S. Virgin Islands real property:
 - Includes land and buildings and other improvements on the land
 - Includes growing crops and timber; and mines, wells, and other natural deposits that have not been severed or extracted from the land
 - Includes “personal property associated with the use” of the land
 - Includes “shared appreciation loans” (i.e., loans with direct or indirect rights to share in appreciation in value, gross or net proceeds, or profits from real property)
 - Interest in U.S. corporation that was a “U.S. real property holding corporation” (“USRPHC”) at any time during the shorter of: (i) the 5-year period preceding sale, or (ii) the taxpayer’s holding period
- Gains from sale or exchange of foreign taxpayers’ interests in partnerships, trusts, or estates that hold USRPIs are treated as received from the sale or exchange of USRPIs to the extent attributable to such USRPIs

FIRPTA: U.S. Real Property Interests (cont'd.)

- USRPI does not include:
 - Interests in real property held solely as a creditor (Treas. Reg. § 1.897-1(c), (d))
 - Mortgage loans at fixed rate or variable rate of interest (such as prime, LIBOR, etc.) that is not principally tied to the fluctuation of the value of real property (Treas. Reg. § 1.897-1(d)(2)(ii)(D))
 - Shared appreciation loans are treated as USRPIs
 - Interests in REITs, provided that the REIT is: (1) “domestically controlled,” (2) not a USRPHC, or (3) publicly traded and the foreign shareholder owned less than 5% in the last 5 years (§ 897(h))

FIRPTA: U.S. Real Property Holding Corporation

- Definition of USRPHC (§ 897(c)(2)):
 - A U.S. corporation where the fair market value of USRPIs held on any “applicable determination date” equals or exceeds:
 - 50% of sum of FMVs of :
 - (i) USRPIs;
 - (ii) non-U.S. real property interests; and
 - (iii) other trade or business assets
- When making a USRPHC determination, must apply a look-through rule for assets held through certain entities
 - Assets of a subsidiary corporation are proportionately taken into account for USRPHC determinations if the parent corporation owns more than 50% of the subsidiary
 - Partnership, trust, or estate assets are taken into account on a proportionate basis according to the corporation’s interest

FIRPTA: U.S. Real Property Holding Corporation (cont'd.)

- Can include interests in REITs, subject to exceptions
- USRPI does not include interest in corporation that has sold all of its USRPIs in taxable transactions
- Interest in regularly traded class of stock is a USRPI only if taxpayer owned 5% or more of class

Taxation of Foreign Taxpayers: Operating Income

- Foreign taxpayers' income that is “effectively connected with a U.S. trade or business” is taxed at regular U.S. rates (individual or corporate)
- Foreign taxpayers may elect to treat certain passive types of real estate income as effectively connected (e.g., rents and royalties from mineral interests) – §§ 871(d), 882(d)
 - Cannot switch back and forth each year; must wait 5 years after revoking the election

Taxation of Foreign Taxpayers: Rents, Interest, and Dividends

- Foreign taxpayers are subject to a 30% tax on all fixed, determinable, annual, or periodic income (“FDAP income”) from U.S. sources
- FDAP income includes rents, interest, and dividends
- Certain exceptions apply to interest that is not ECI
 - Short-term OID
 - Bank interest
 - Portfolio interest exemption
 - exceptions where loan made by foreign bank, “10-percent shareholder” or “10-percent partner”; also not applicable if interest is contingent
 - Unregistered loans are not eligible for this exception; mortgages are typically unregistered, but this defect can be cured through the use of a grantor trust
 - Many treaties eliminate or reduce rate of tax
- Treaties typically reduce dividend withholding rate to 5% or 15%

Additional Taxation of Foreign Corporations

- Foreign corporation that is engaged in a U.S. trade or business (including through the ownership or sale of U.S. real property) is taxed at regular U.S. corporate rates (35%)
- In addition, the foreign corporation is subject to branch-level taxes (§ 884)
- Branch taxes are intended to treat U.S. trade or business as if it were a separate U.S. corporation (i.e., mimics U.S. corporate double-taxation):
 - Dividend tax rate \times “dividend equivalent amount”
 - Interest tax rate \times interest allocated to U.S. branch
 - Treaties often reduce or even eliminate branch taxes
- Dividend equivalent does not apply to liquidation proceeds, if formalities met

U.S. Tax Withholding

- Source withholding ensures that the U.S. will collect taxes from individuals and entities that are outside the IRS's reach
- U.S. withholding agent (the U.S. person in possession of income that will be paid to a foreign person) is liable for the tax if not properly withheld and withholding agent did not receive adequate documentation (Forms W-8, W-9)
- Withholding regimes:
 - FIRPTA: § 1445
 - FDAP: § 1441; 1442
 - Partnerships: § 1446
 - FATCA: § 1471 *et. seq.*

Withholding: FIRPTA (§ 1445)

- FIRPTA requires that purchasers withhold 10% of gross amount realized from sale or exchange of USRPI by a nonresident
 - Some states also require withholding on sale by nonresident
 - Excess withholding can be avoided based on maximum tax (see IRS Form 8288-B and Rev. Proc. 2000-35)
- Exemptions:
 - Non-foreign affidavit
 - Non-USRPHC affidavit
 - Sales price <\$300,000 on property that will be transferee's residence (amount not indexed for inflation in >30 years)
 - Publicly traded stock
 - Situations where withholding is required under partnership withholding rules (§ 1446)

Withholding: FIRPTA (§ 1445) (cont'd.)

- U.S. partnerships, trusts, and estates must withhold tax (generally at a rate of 35%) on gain realized from the disposition of USRPI to the extent such gain is allocable:
 - To foreign partner/beneficiary of the partnership, trust, or estate; or
 - To foreign owner of the trust under the grantor trust rules
- Foreign corporations (that do not elect domestic treatment) must withhold a 35% tax on the amount of gain recognized in a distribution of a USRPI that is taxable under § 897(d) or (e)
- USRPHC must withhold 10% tax of FMV of USRPI distributed in redemption or liquidation to foreign shareholder
- Non-excepted REITs must withhold tax (generally at a rate of 35%) on distributions to foreign shareholders to the extent the distribution is attributable to gain on U.S. real estate

Withholding: Rents, Interest, Dividends (§§ 1441 & 1442)

- Payor must withhold 30% of gross amount of U.S. source FDAP income (rent, interest, dividends) paid to foreign individual or corporation
- As a practical matter, it is risky to assume that a real estate asset will not be deemed to cause a foreign owner to have ECI
- Treaties can reduce or exempt payments from withholding, if foreign person certifies its entitlement to treaty benefits (typically on Form W-8BEN)

Withholding: Partnerships (§ 1446)

- A partnership must withhold on its foreign partner's allocable share of "effectively connected taxable income" (ECTI)
 - ECTI is generally the partnership's taxable income computed with consideration of only those partnership items which are effectively connected with a U.S. trade or business
- Applicable rate is the highest rate under § 1 or § 11
 - Long-term capital gains rates can apply to individual partner
- Over-withholding is often a problem
- Publicly traded partnerships (Treas. Reg. §1.1446-4)
 - Withholding based on distributions, not income allocations
 - Preferential rates may not be used

Withholding: FATCA (§§ 1471-1474)

- Foreign Accounts Tax Compliance Act (FATCA) is generally beyond the scope of this presentation because it's targeted at catching unreported income of *U.S. taxpayers*
- FATCA can require withholding on certain payments to foreign accounts, entities, or financial institutions that would not otherwise be subject to withholding, e.g.:
 - Income subject to no or reduced withholding by treaty
 - Proceeds from the sale of non-USRPHC stock
 - Proceeds from the sale of domestically controlled REIT
- Withholding to be phased-in beginning on 1/1/2014 (unless delayed again)
- Identification and reporting regime may apply to certain non-U.S. real estate funds or holding companies

Section 892

- Section 892 generally provides foreign governmental entities and sovereign wealth funds with an exemption on ordinary income dividends, interest, and FIRPTA capital gains attributable to the sale of stock. However, there are numerous traps, including:
 - An entity wholly owned by an 892 entity will be treated as a corporation, and if such entity is not located in the 892 entity's home country will not be eligible for 892
 - Commercial activities can terminate an otherwise eligible 892 entity's status (including non-U.S. commercial activities)
 - If 892 entities derived from the same sovereign own more than 50% of an underlying U.S. corporation, 892 benefits will generally not apply
 - In general, if an 892 entity would be a USRPHC if it were a US entity, it will be treated as engaged in commercial activities and not be eligible for section 892 benefits (the application of this test to investment entities can be very complicated)
 - The IRS has taken the position that 892 does not protect an 892 entity with respect to FIRPTA distributions from REITs

Verification Code #1

- TYXATI

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

Analysis of Investment Structures

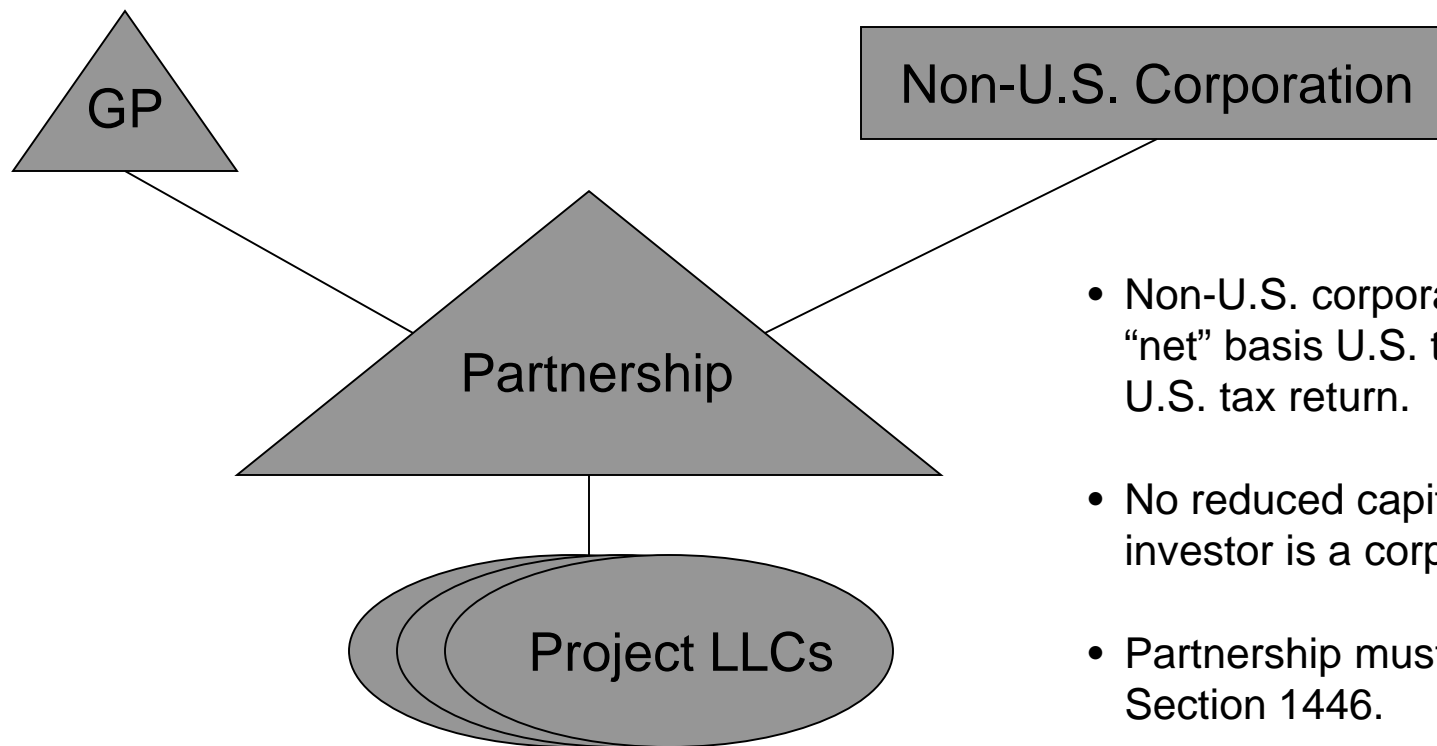
Types of Investment Vehicles and Structures

- Partnerships
- REITs
- Corporations
- Combinations

Partnerships

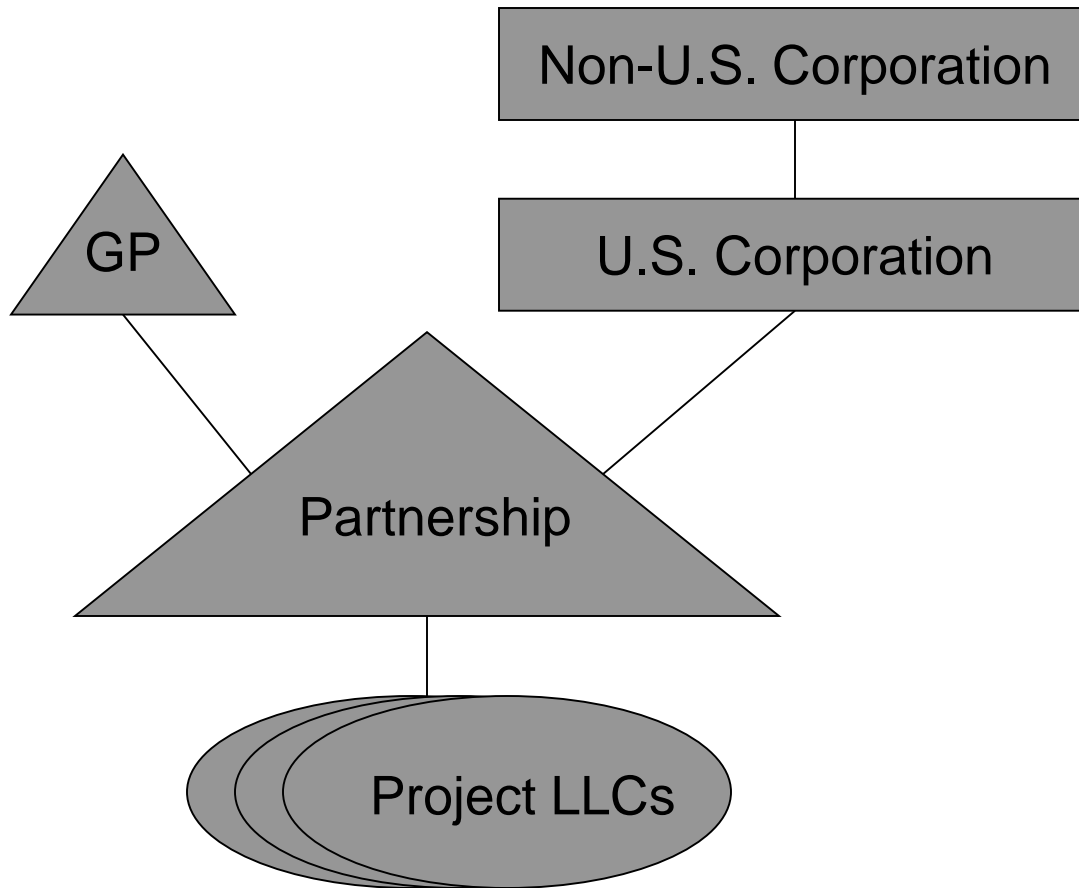
- **ECI.** Any Partnership ECI will be attributed to a foreign limited partner. Mezzanine funds may have ECI due to a lending business
- **Blocker Corporations.** The foreign investor may wish to use a blocker, but it is hard to structure such a vehicle in an efficient way.
- **Filing Obligations.** The foreign investor will need to file in the United States.

Diagram 1



- Non-U.S. corporation subject to “net” basis U.S. taxation. Must file U.S. tax return.
- No reduced capital gain rate since investor is a corporation.
- Partnership must withhold under Section 1446.
- Branch profits tax generally applies unless complete termination.
- No U.S. estate tax on ultimate shareholders.

Diagram 2

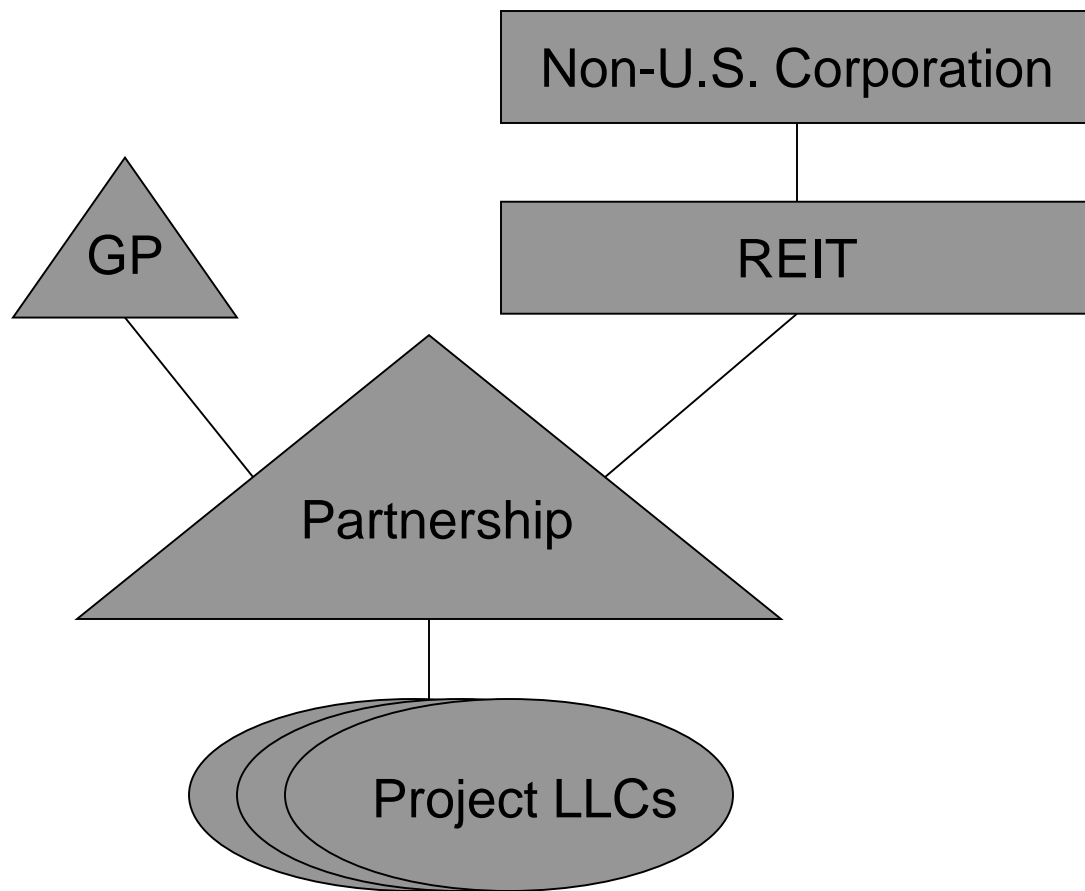


- U.S. corporation subject to “net” basis U.S. taxation. Must file U.S. tax return.
- No reduced capital gain rate since investor is a corporation.
- U.S. corporation may pay deductible interest to non-U.S. parent. Such interest is subject to 30% withholding, unless reduced by treaty
- Dividends from U.S. corporation subject to 30% withholding, unless reduced by treaty
- Gain on disposition of shares in U.S. corporation subject to FIRPTA unless U.S. corporation has disposed of all U.S. real estate in taxable transactions.
- No U.S. estate tax on ultimate shareholders.

REITs

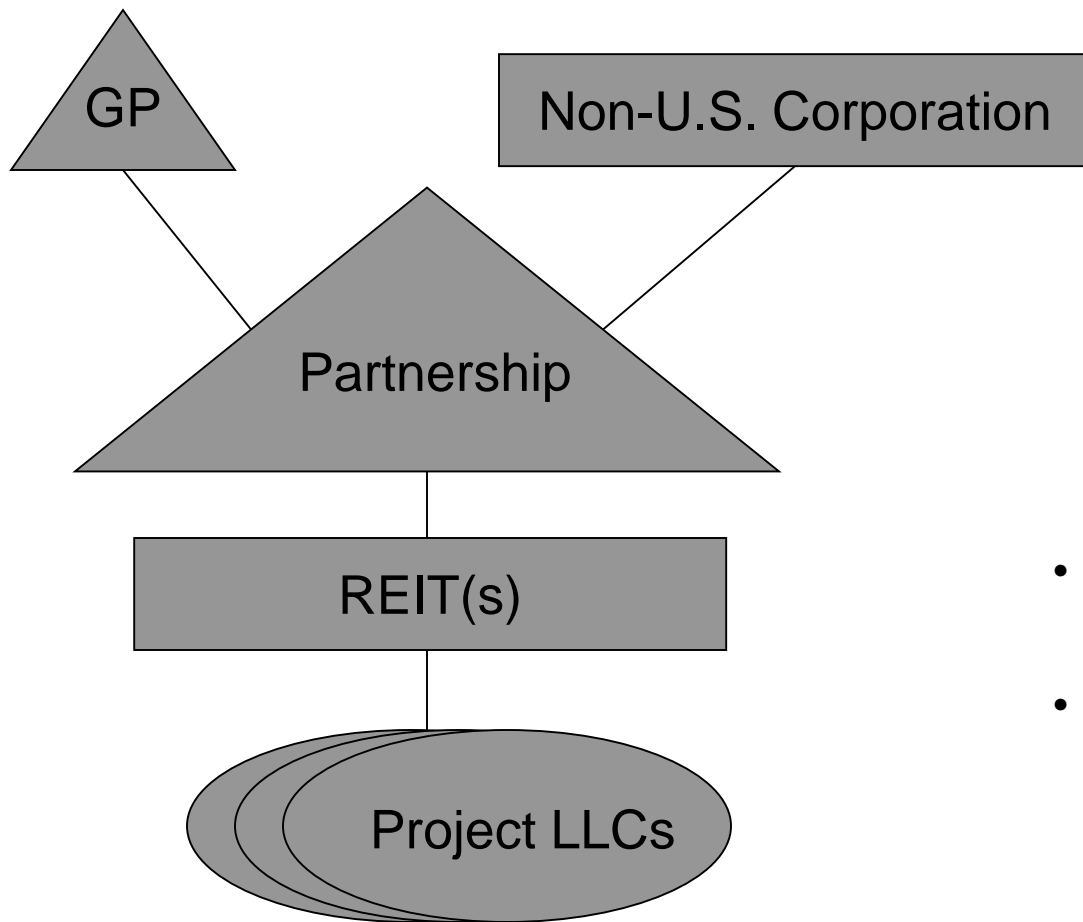
- **Qualification.** Before choosing to form a REIT, a fund should seriously consider whether the REIT qualification tests are compatible with the proposed business plan (e.g., no inventory).
- **Preferential Dividend Rules.** Beware of the application of some of these rules to REITs. The rules are designed for RICs, not REITs.
- **ECI.** REITs “filter” ECI.
- **Withholding.** Unless a foreign investor has a favorable tax treaty, the withholding on ordinary dividends can be substantial.
- **FIRPTA.** For most non-mezzanine real estate funds
 - Sales of shares will trigger FIRPTA unless the domestically controlled or public trading exceptions apply.
 - Capital gain distributions may be subject to FIRPTA unless the public trading exception applies.

Diagram 3



- Ordinary dividends subject to 30% withholding.
- Distributions “attributable to” gain from sale of U.S. real estate subject to FIRPTA. Must file U.S. tax return. Subject to branch profits tax.
- Much-criticized Notice 2007-55 applies this to liquidating distributions.
- Sale of REIT shares not subject to FIRPTA if REIT is “domestically controlled.”

Diagram 4

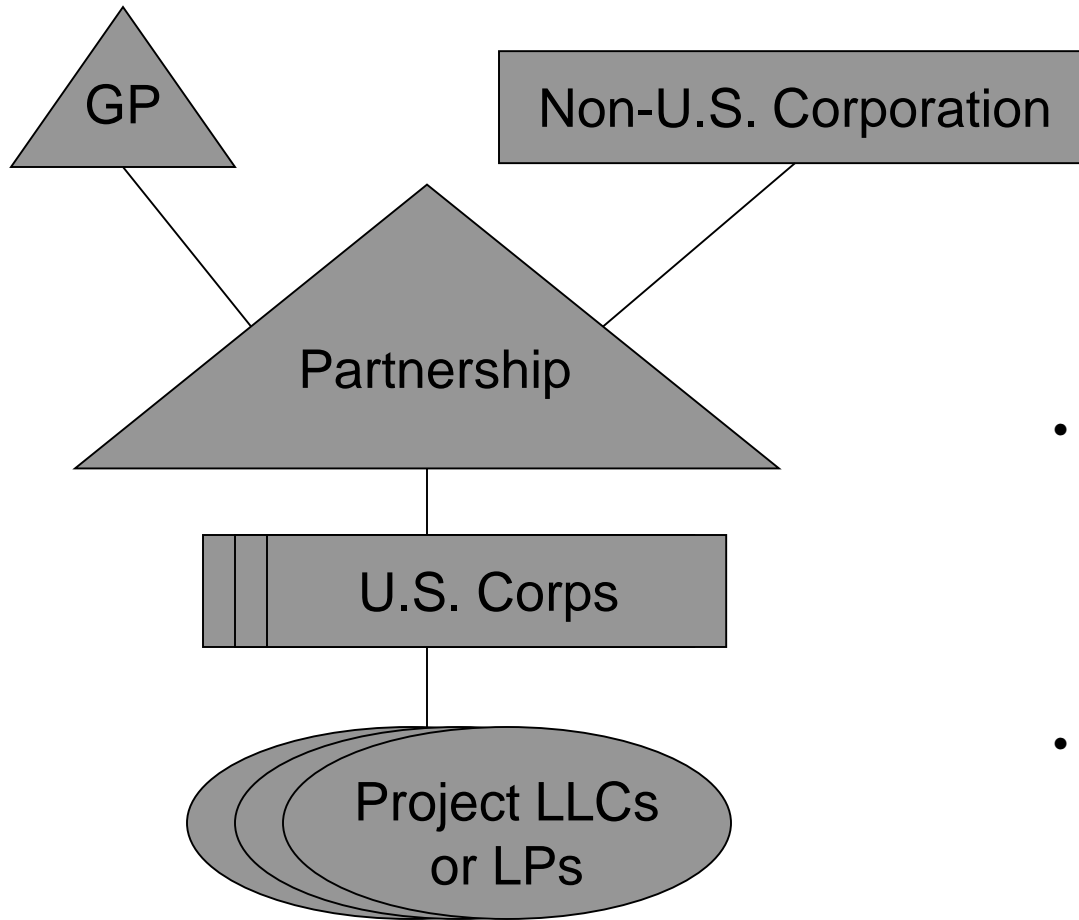


- Same as Diagram 3 except investor unable directly to sell REIT shares.
- If Partnership sells REIT shares, not subject to FIRPTA if REIT is “domestically controlled”

U.S. Corporations

- **Corporate Tax.** A domestic corporation will be subject to U.S. federal income tax (and state taxes), but the investor will not incur ECI
- **FIRPTA.** Unless the corporation has disposed of its assets, the sale of stock may trigger FIRPTA
- **Withholding.** Liquidating distributions may be tax free, but current distributions may be subject to withholding

Diagram 5

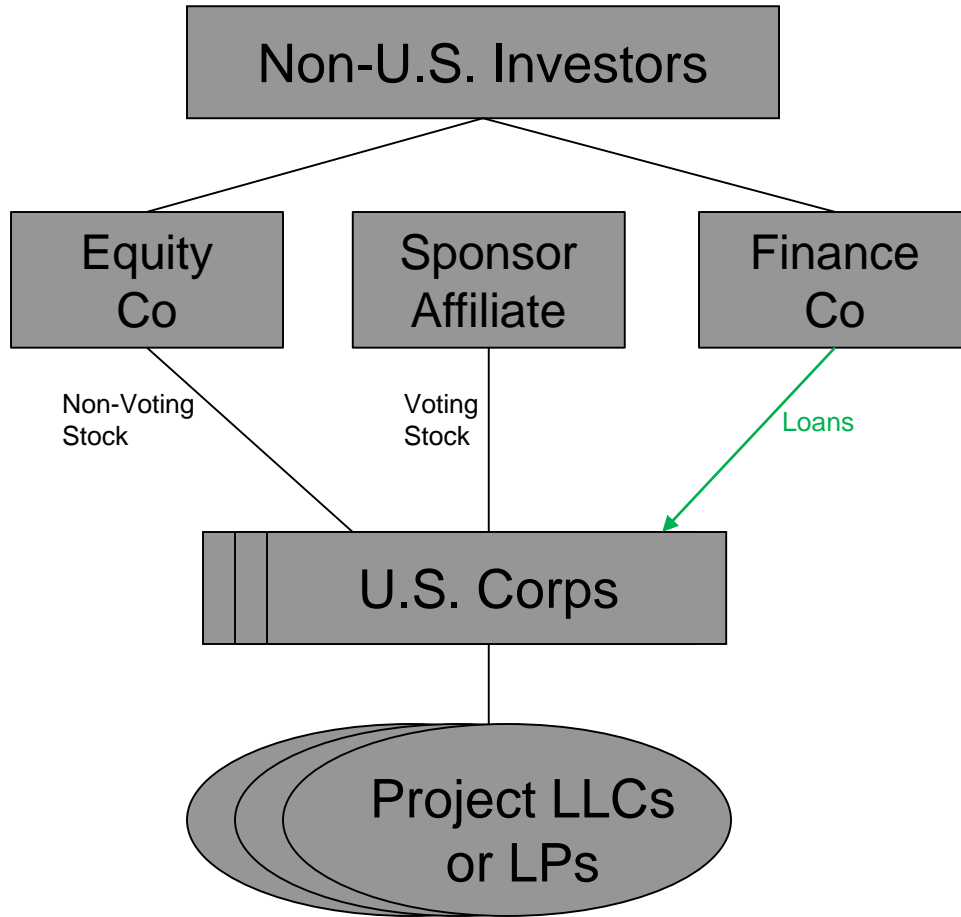


- A separate U.S. corp is set up for each project. That U.S. corp is subject to tax on operating income and sale gain. Thereafter, U.S. corp ceases to be a USRPHC and may be liquidated free of further tax.
- Any dividends paid from a U.S. corp's earnings and profits subject to 30% withholding.

Use of Leverage

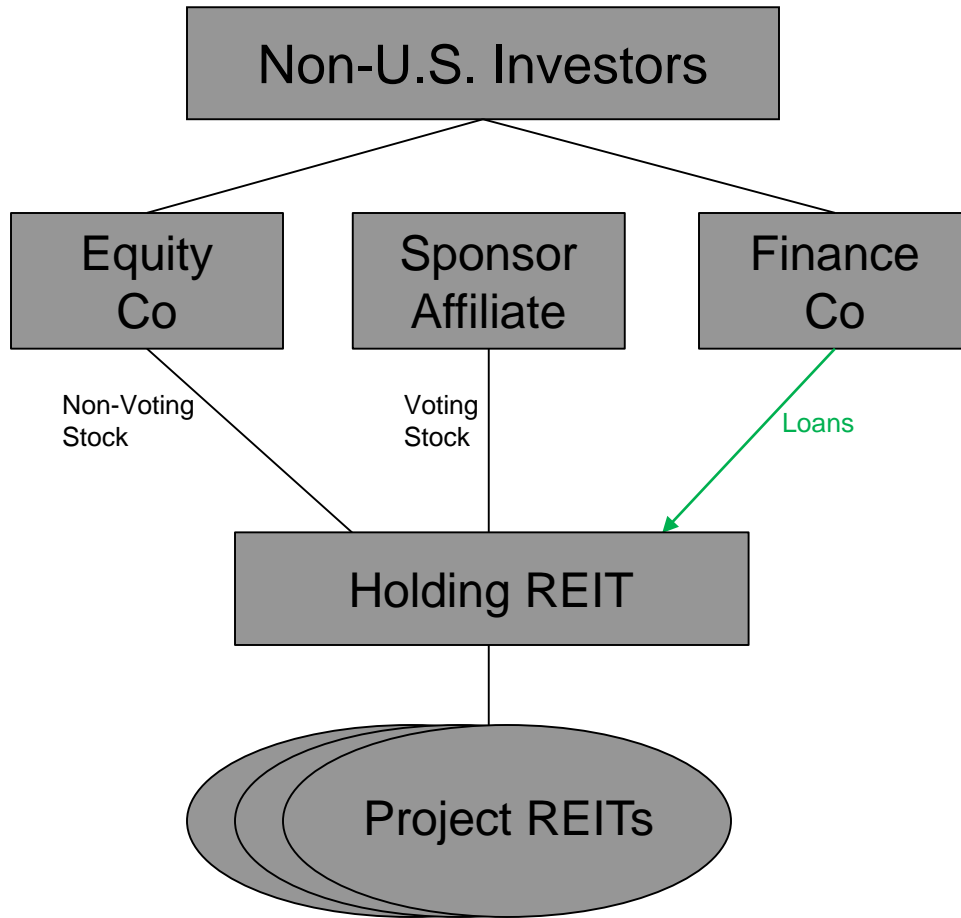
- Debt-Equity Issues
- Portfolio Interest Rules
- Earnings Stripping Rules

Diagram 6



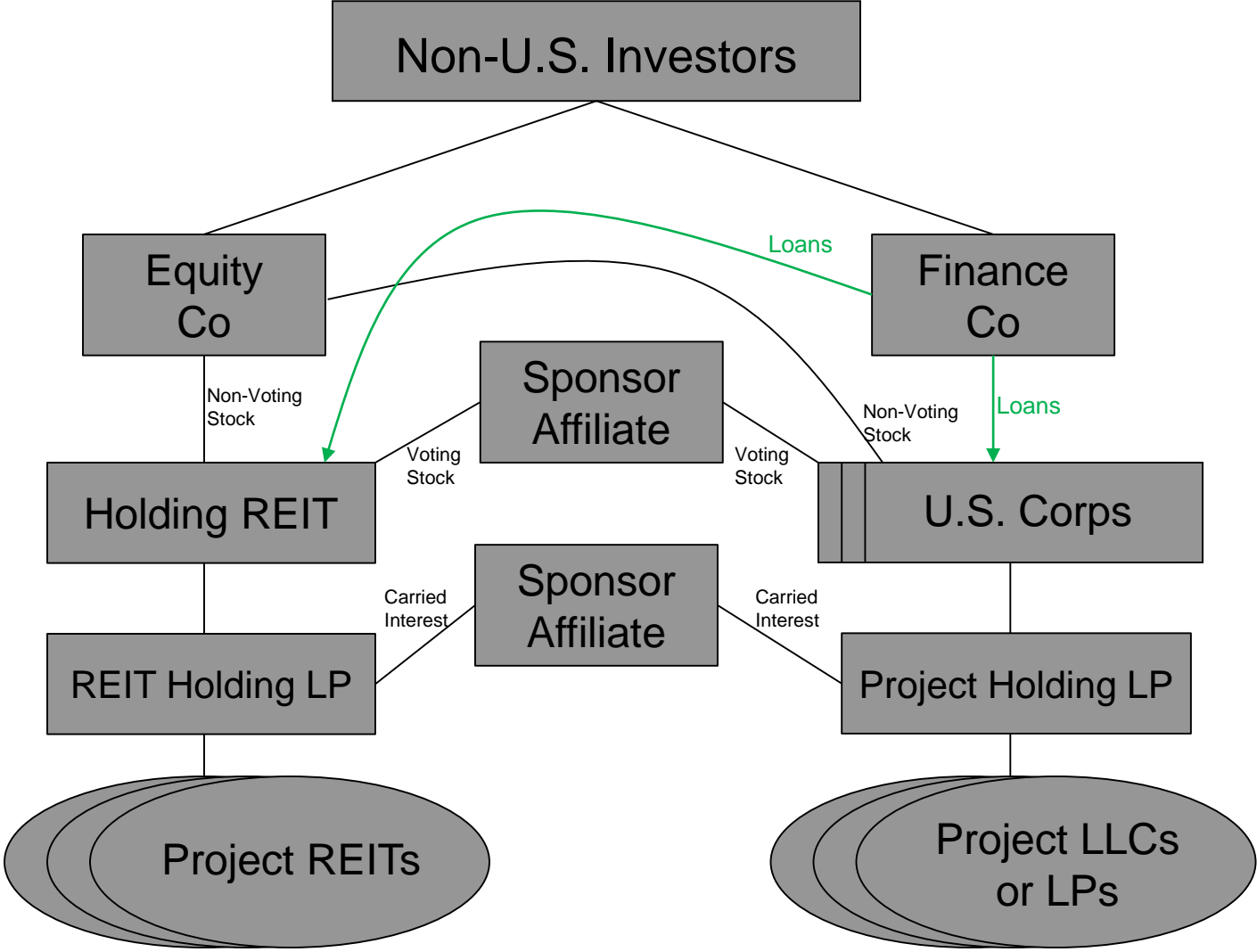
- A separate U.S. corp is set up for each project. That U.S. corp is subject to tax on operating income and sale gain. Thereafter, U.S. corp ceases to be a USRPHC and may be liquidated free of further tax.
- Any dividends paid from a U.S. corp's earnings and profits subject to 30% withholding.
- Interest paid to Finance corp not subject to withholding (not paid to a 10% shareholder).
- Interest paid to Finance corp is deductible by U.S. corp, subject to earnings stripping rules of Section 163(j).

Diagram 7



- Ordinary dividends paid from Holding REIT subject to 30% withholding.
- Distributions “attributable to” gain from sale of U.S. real estate paid from Holding REIT subject to FIRPTA.
- If Holding REIT sells shares of a Project REIT, not subject to FIRPTA if Project REIT is “domestically controlled.”
- Liquidation of a Project REIT—unclear.
- Interest paid to Finance corp not subject to withholding (not paid to a 10% shareholder).
- Interest paid to Finance corp is deductible by U.S. corp, subject to earnings stripping rules of Section 163(j).

Diagram 8



Verification Code #2

- invest

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

Basic Estate and Gift Tax Rules

Estate & Gift Tax Residency

- Subjective Test
- A U.S. resident for transfer-tax purposes is a person who is “domiciled” in the U.S. at the time of death or at the time of the gift
 - A person acquires domicile in a place by **living there**, for even a brief period of time, with no definite present **intention** to leave
- An individual can be a resident for income-tax purposes and not for transfer-tax purposes, and vice-versa
 - There is no “perfect” holding structure for real estate, but it’s even more challenging for a client who is income-tax resident and transfer-tax nonresident

Gift Tax

- Nonresident aliens are taxed **only** on gifts of:
 - U.S.-situated tangible property
 - U.S.-situated real estate
- Gifts of U.S. stock are **not** subject to tax
- Gifts of partnership interests **may not** be subject to tax, but this result is less certain
 - Uncertainty should lead to conservative planning

Gift Tax

- Annual exclusion is available to nonresident aliens. In 2013, annual exclusion amounts are:
 - \$14,000 for gifts to non-spouses
 - \$143,000 for gifts to non-citizen spouses
 - QDOT not available for *inter vivos* gifts (only testamentary)
- No unified credit; all gifts above annual exclusion to non-spouses or to non-citizen spouses are taxable
- Unlimited marital deduction for gifts to citizen spouses

Estate Tax

- Nonresident aliens are subject to estate tax on **property located in the United States**. Includes:
 - U.S. real property
 - Tangible personal property located in the U.S.
 - Debt obligations of U.S. persons, unless portfolio exemption applies
 - FATCA removed ability to structure private loans to qualify for portfolio exemption
 - Stock in U.S. corporations (whether or not publicly traded)
 - Uncertain treatment of foreign partnership interests
 - No bright line rule
 - Some authorities use “aggregate” approach, and some use the “entity” approach
 - If partnership is engaged in U.S. trade or business, clearly a U.S. asset
 - Uncertainty on this issue should lead to conservative planning

Estate Tax

- Trusts
 - Revocable trusts or trusts in which the decedent retained an interest under which a transferred asset could be “clawed back” under Code Sections 2033 through 2038
 - Look to situs of assets
 - Ensure that only foreign assets are transferred to the trust
 - If the nonresident alien transfers a U.S. asset to the trust, and then the trust later sells the U.S. asset and buys a foreign asset, there will be estate inclusion (Code Section 2104)
 - Irrevocable trusts
 - Structure like a typical completed-gift trust to ensure no estate inclusion

Estate Tax

- Limited to \$60,000 estate-tax exemption (\$13,000 tax credit)
- Unlimited marital deduction if assets left to a spouse who is a U.S. citizen
 - QDOT must be used to defer estate tax if surviving spouse is a non-citizen
- Charitable deduction and deduction for estate administration expenses
 - Ratio of U.S. assets to worldwide assets
- Nonrecourse debt on U.S. property results in only net value included in U.S. estate

Covered Expatriates: New “Inheritance Tax”

- **Gifts** or **bequests** from “covered expatriates” to a U.S. citizen or resident (including a domestic trust) are subject to an inheritance-type tax instead of a transfer tax
 - Meaning that the tax is **payable by the U.S. recipient**
 - Covered **gifts** taxed only to the extent exceed annual exclusion
- Covered gift/bequest to foreign trust taxed only when distribution attributable to the gift/bequest made to U.S. beneficiary
 - How to administer?
- Exception for transfers that are otherwise subject to U.S. transfer tax and reported on a gift- or estate-tax return
- Tax is reduced by foreign gift tax or estate tax

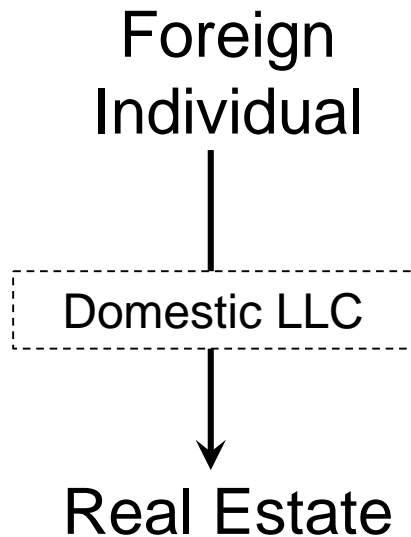
Verification Code #3

- taxes

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

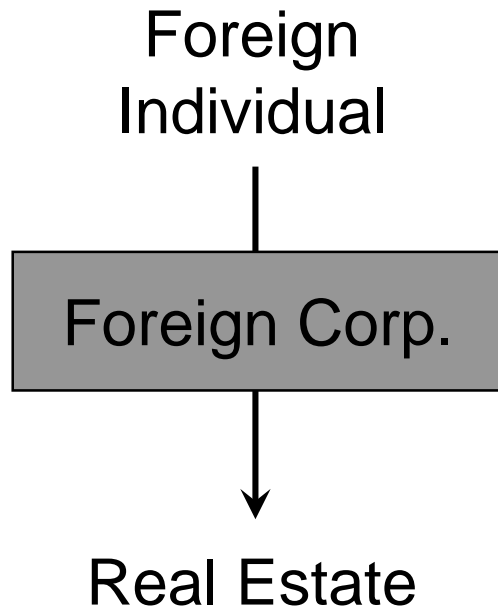
Analysis of Ownership Structures

Individual / U.S. LLC Ownership



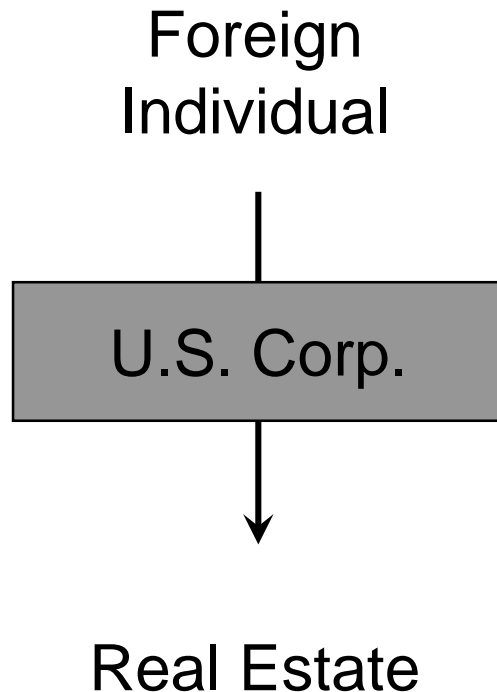
- Individual ownership is the same as ownership through a domestic LLC for tax purposes
- Estate tax
- Gift tax
- One level of income tax
- Privacy concerns with individual ownership; can be mitigated with LLC

Ownership through Foreign Corporation



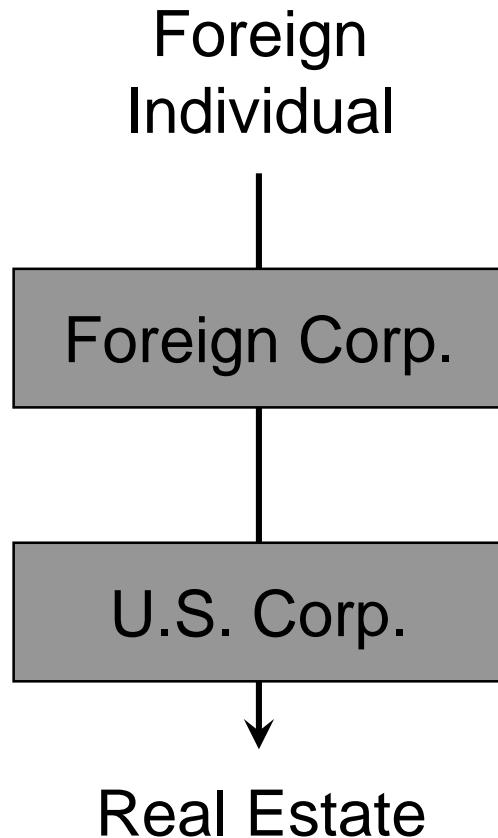
- No estate tax
- No gift tax
- Branch profits tax
- Addresses privacy concerns
- Sale of stock is non-taxable (unless corporation elects to be treated as a USRPHC)
- Gain on distribution of real estate to foreign individual (with one complicated exception under § 897(d))
- Built-in gain problem for heirs

Ownership through U.S. Corporation



- Estate tax
- No gift tax
- No branch profits tax
- Dividend withholding tax
- Privacy concerns are mitigated
- Sale of stock is a disposition of a USRPI
- Gain on distribution of real estate to foreign individual

Ownership through Foreign and U.S. Corporations



- No estate tax
- No gift tax
- No branch profits tax
- Addresses privacy concerns
- Sale of stock is non-taxable
- Gain on distribution of real estate to foreign corporation, unless it's a liquidating distribution
- Built-in gain problem remains for heirs

Verification Code #4

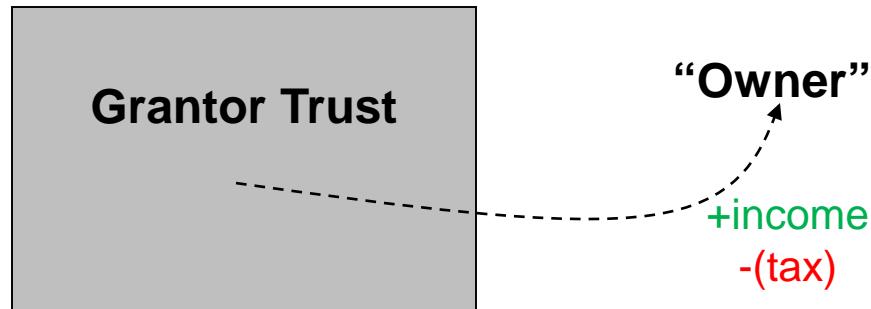
- 889900

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

Ownership through Trusts

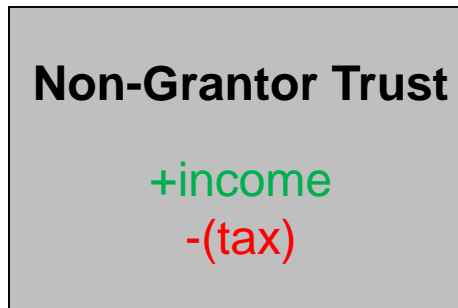
- Generally only for gifting
- Foreign trust is usually not desirable if there are only U.S. beneficiaries
- Need to understand intricacies of grantor trust status versus non-grantor trust status

Grantor Trusts



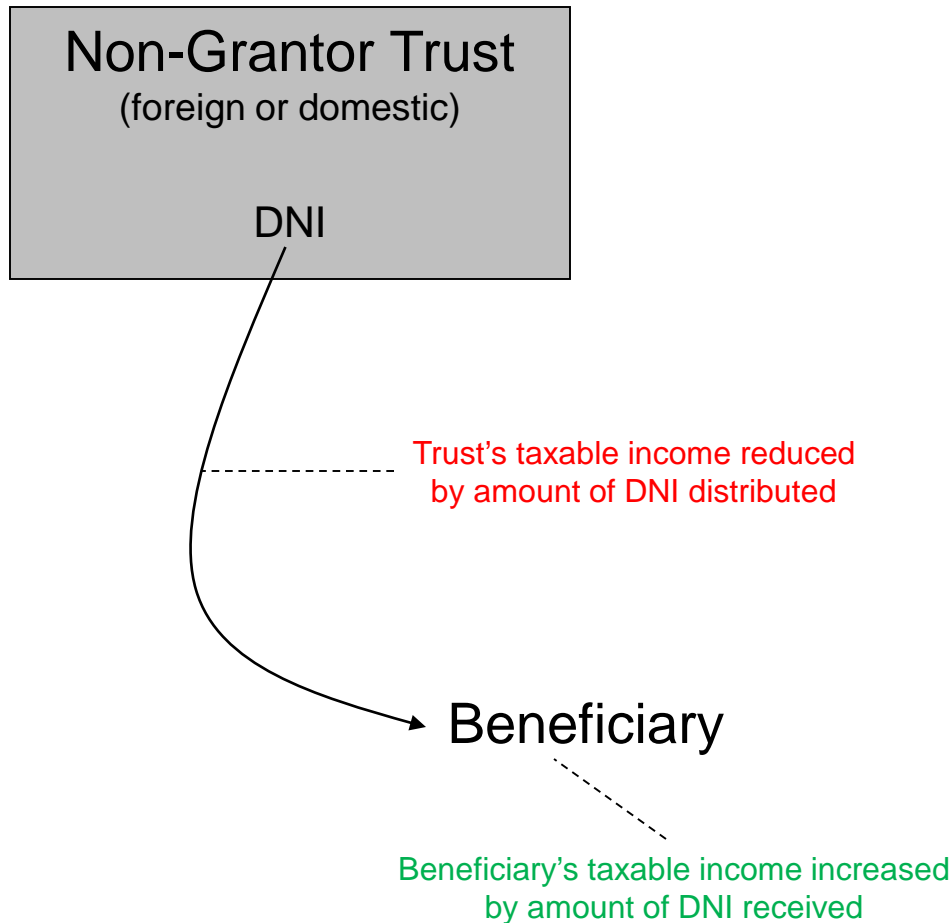
- The trust's "owner" is deemed to own the trust's income for U.S. tax purposes
- Income is currently taxable to the owner (whether or not it is distributed); therefore, beneficiaries not taxable on distributions
- If the owner is a foreign person, subject to U.S. tax only on certain U.S.-sourced income
 - A trust properly characterized as having a foreign owner can provide complete avoidance of U.S. tax on trust income, even when it is distributed to U.S. beneficiaries
 - Grantor-trust status as to a foreign person will not solve estate-tax problem on U.S. assets in the trust because trust must be revocable, or grantor & spouse must be the only beneficiaries

Non-Grantor Trusts



- Income is considered to be “owned” by the trust itself
- If it’s a U.S. trust, it pays tax on worldwide income (to the extent not distributed)
- If it’s a foreign trust, it pays tax only on certain U.S.-source income (to the extent not distributed)
 - This could provide an opportunity for deferral of U.S. tax until distributed to U.S. beneficiaries
 - To preclude this deferral, “throwback” rules apply to income accumulated within a foreign non-grantor trust and later distributed to U.S. beneficiaries

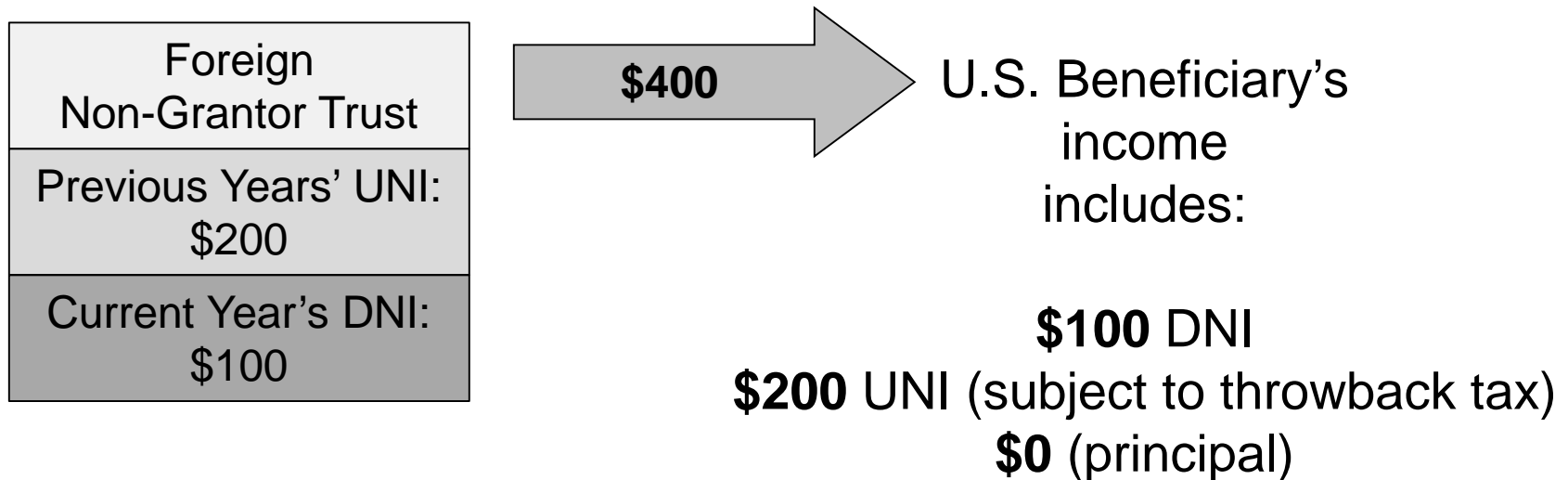
Non-Grantor Trusts: Taxation of Distributions



- In computing taxable income, the trust receives a deduction equal to DNI distributed
- The beneficiaries must include in income their pro-rata share of DNI
- Foreign non-grantor trusts with U.S. beneficiaries must account for all income as though it were a U.S. trust, even though the trust itself is generally not subject to U.S. taxation

Foreign Non-Grantor Trusts

- An “accumulation distribution” is one that exceeds current-year DNI
- After all DNI is distributed, distribution is deemed to consist of UNI until no UNI remains
- After all UNI is distributed, the distribution will be considered non-taxable principal



Foreign Non-Grantor Trusts

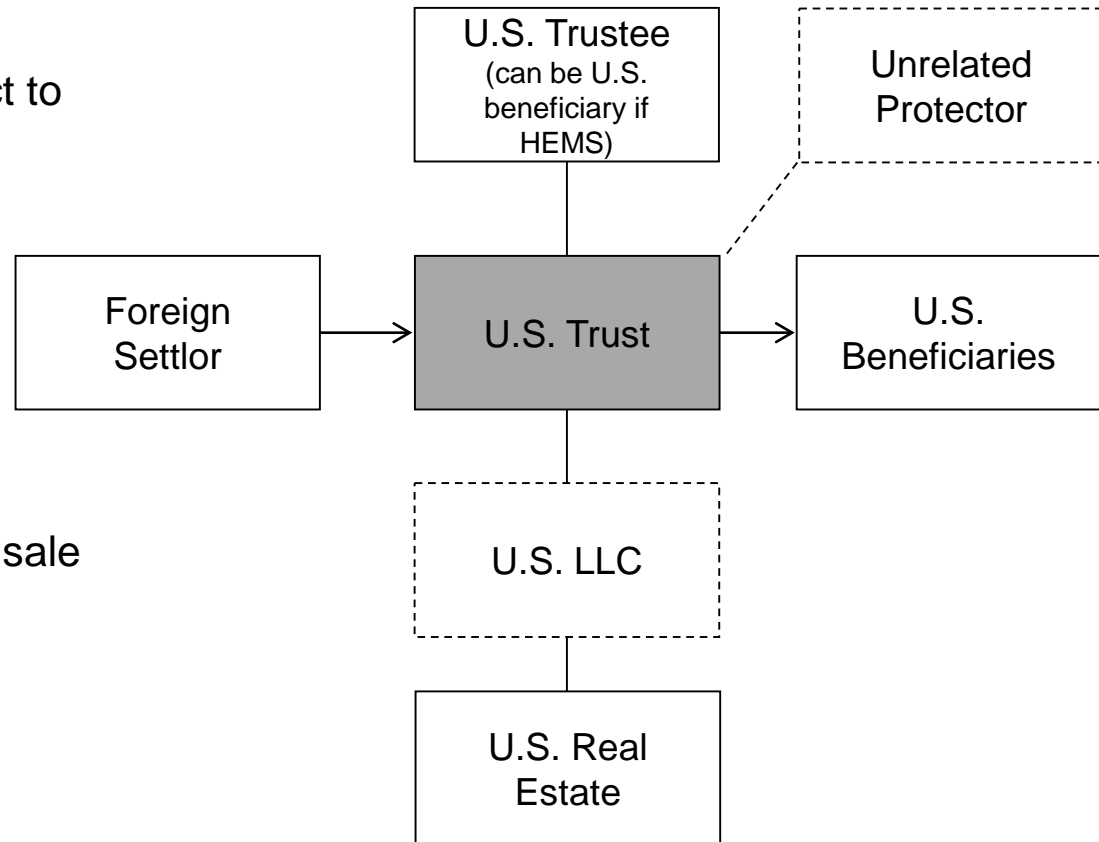
- Once a foreign non-grantor trust has UNI, it remains in the trust until it is distributed
 - UNI can be distributed to a foreign beneficiary without triggering the throwback tax (but beware of loopholes below)
- Loopholes for improperly avoiding throwback have been closed
 - Distributing funds to a foreign beneficiary who then “gifts” it to a U.S. beneficiary is an accumulation distribution to the U.S. beneficiary
 - Transferring funds from one trust to another trust can be considered an accumulation distribution in some cases
 - Rent-free use of trust property will carry out UNI

Foreign Non-Grantor Trusts

- Foreign non-grantor trusts can provide some good planning opportunities for foreign investment in U.S. real estate, but throwback-tax complications for U.S. beneficiaries can lean in favor of using a U.S. trust instead

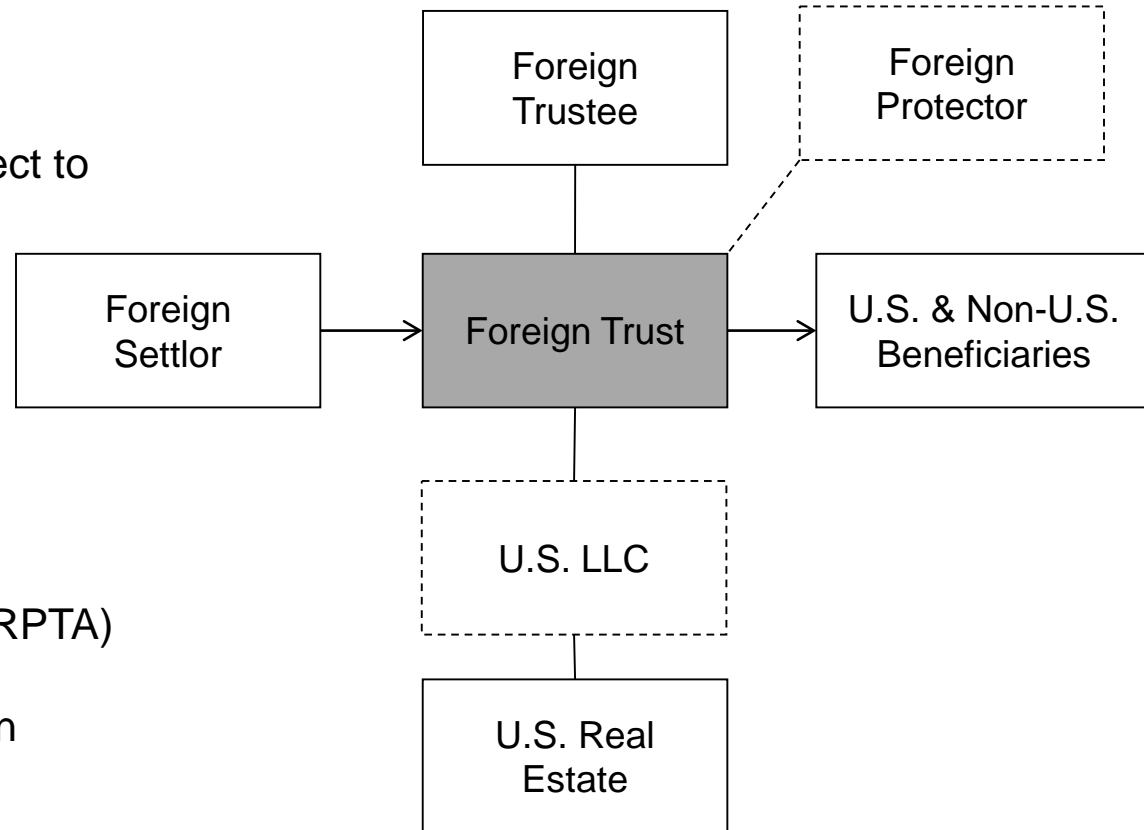
Ownership through U.S. Trust

- Foreign person must sell (subject to FIRPTA), or gift in increments
- Non-grantor trust
- No U.S. estate tax
- No GST tax
- Regular U.S. tax on subsequent sale
- Include redomiciliation provision



Ownership through Foreign Trust

- Foreign person must sell (subject to FIRPTA), or gift in increments
- Non-grantor trust
- No U.S. estate tax
- No GST tax
- Subsequent sale (subject to FIRPTA)
- Include redomiciliation provision



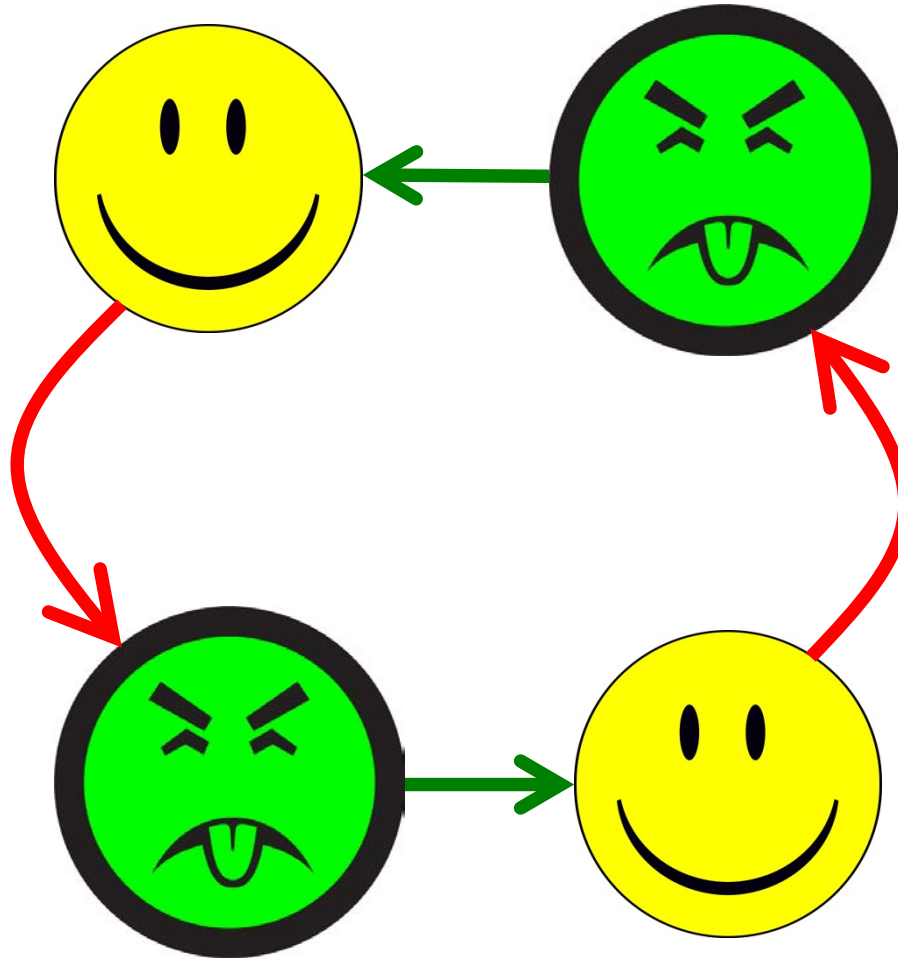
There Is No Perfect Solution

Direct ownership or pass-through entity:

- capital gains rates
- no double taxation
- simple

Direct ownership or pass-through entity:

- personal tax filings
- estate tax
- gift tax



Corporate ownership:

- corporate rates
- double taxation
- branch profits
- built-in gain

Corporate ownership:

- no personal tax filings
- no estate tax (with foreign entity)
- no gift tax

Q&A

To ask a question from your touchtone phone, press *1.

To exit the queue, press *1 again.

You may also use the Chat function to ask questions, or email questions to accountingquestion@straffordpub.com

Verification Code #5

- foreign

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

Verification Code #6

- property

Note: Answers **MUST** be submitted on your Official Record of Attendance form used for continuing education credit. If you have not already printed one, the form is posted in the “Handouts” tab in the “Conference Materials” box in the left-hand side of your screen.

Tell us how we did!

After you complete a brief survey of this program, we'll send you a **free \$5 Starbucks Gift Card**.

Look for our 'Thank You' email (which you should receive shortly) for details and the survey link!

Thanks.

Please join us for our next conference, "Partnership Basis and Distributions: Navigating Sections 731-737, 751(b) and 755," scheduled on Wednesday, July 17, 2013 starting at 1pm EDT.

Strafford Publications, Inc.
1-800-926-7926
www.straffordpub.com