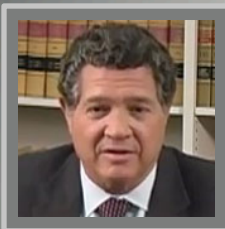


U.S. Taxation of Foreign Investors

Non Resident Alien Individuals & Foreign Corporations

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- Richard Lehman regularly works with law firms, accountants, businesses and individuals struggling to find their way through the complexities of the tax law. *In short, Lehman is a valuable resource to each of these audiences.*
- With over 43 years as a tax lawyer in Florida, Lehman has built a national reputation for being able to handle the toughest tax cases, structure the most sophisticated income tax and estate tax plans, and defend clients before the IRS.

Over 38 years of Florida real estate experience with foreign investors that purchase:

- shopping centers
- rental apartments
- rental apartment houses
- warehouses
- land acquisitions
- real estate development deals of all types

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Define The Foreign Investor

- **Non Resident Alien Individual**

A non U.S. citizen individual who is NOT a Resident Alien

NOTE: Resident Alien (Resident for U.S. Income Tax Purposes)

- **Foreign Corporations**

A Foreign Corporation is any corporation that is not formed in the United States or under the laws of the United States or any state.

TAXATION PATTERN

U.S. Resident Alien ("Tax Resident") - Subject to Taxation

1. Income Taxation - Worldwide Income
2. Estate Taxation - Worldwide Assets
3. Gift Taxation - Worldwide Assets

Non Resident Alien Individual Investor – Subject to Taxation

1. **Income Taxation** - United States source income, limited type of foreign Source income
2. **Estate Tax** - United States Situs assets only (includes real estate)
3. **Gift Tax** - real and tangible personal property with a United States Situs (Except no shares of stock)

****Branch Tax** - Corporations only

STATUS FOR TAX PURPOSES

A. Non-Resident Alien - Not a “Resident Alien”

B. Resident for Income Tax Purposes

1. Green Card
2. Substantial Presence Test
3. Voluntary Election

Exceptions:

4. The Closer Connection
5. Treaties: Tie Breaker

C. Foreign Corporations

Substantial Presence Test

NON RESIDENT ALIEN			RESIDENT ALIEN		
Residency "Days"	Days in US	Year	Formula	Days in US	Residency "Days"
120	120	2017	100%	120	120
40	120	2016	33.33%	150	50
20	120	2015	16.67%	120	20
180	Total			Total	190

EXCEPTIONAL CIRCUMSTANCES AND SPECIAL BENEFITS

Students

- A foreign student who has obtained the proper immigration status will be **exempt** from being treated as a U.S. resident for U.S. tax purposes even if he or she is here for a substantial time period that would originally result in the student being taxed as a U.S. resident.
- This student visa not only permits the student to study in the United States, but to pay taxes only on income from U.S. sources not worldwide income.
- The visa also permits the student's direct relatives to accompany the student to the United States and receive the same tax benefits.

TWO TYPES OF FEDERAL INCOME TAXATION PATTERNS

Foreign Taxpayer

Foreign Investors (both Alien Individuals and Foreign Corporations) pay U.S. tax on U.S. income in two entirely different ways depending upon whether the income the Foreign Taxpayer earns is from "passive" sources or whether the income results from the Foreign Taxpayer's conduct of an "active trade or business" in the U.S.

Source of Income Rules

1. U.S. Source Income
2. Foreign Source Income
3. Deductions

Taxation of **Passive** (Non Business Income)

1. 30% Flat Tax Rate - Gross Income (Except Treaties)
2. Withholding Obligations and Contingency

Taxation of **Active Trade or Business** Income

1. Corporate Tax Rates (21%)
2. Graduated Income Tax Rates (10% - 37%*)
3. Effectively Connected Income (10% - 37%*)
4. Income Effectively Connected with a U.S. Business

* Certain types of income maximum tax rates 20% Individual, 21% Corporations.

Treaties

- ✓ Additional tax concessions depending upon income and treaty country.

SEVERAL IMPORTANT EXCEPTIONS

Capital Gains Taxation

- **Alien Individual** = individual tax rates and generally no tax on capital gains (except for real estate and effectively connected income).
- **Foreign Corporation** = corporate tax rates and generally no tax on capital gains

Estate Taxation

1. Alien Individual - Residency for Estate Tax Purposes - \$11,000,000 Exclusion
2. Non Resident Tax Rates **as high as 40% of asset value** - \$60,000 Exclusion

U.S. Real Property

1. U.S. companies holding U.S. Real Property and the U.S. Estate and Gift taxes - U.S. Income No Gift Tax

The Branch Profits Tax (*Foreign Corporation Only*)

Foreign Corporation

1. U.S. Trade or Business
2. Foreign Source Income

SUMMARY

DEFINING THE FOREIGN INVESTOR-INCOME TAX PURPOSES

- Non Resident Alien Individual
- Foreign Corporation

TWO TYPES OF TAXATION

- U.S. Source Income (Passive & Active)
- Active Business Income
- Passive Income

EFFECT OF TAX TREATIES

EXCEPTIONS TO THE RULES

- REAL ESTATE
- EFFECTIVELY CONNECTED INCOME
- BRANCH TAX

Unlike a Foreign Taxpayer that is taxed on passive U.S. source income only...

Income of a Foreign Taxpayer that conducts a trade or business in the U.S. will pay tax on all of its United States source income and in limited circumstances, U.S. tax must be paid on income that is earned from foreign sources and not U.S. sources.

Foreign source income that is attributable to a Foreign Taxpayer's U.S. trade or business activity may be taxed by the U.S. and is called "Effectively Connected Income".

Source of Income Rules

- a. U.S. Source Income
- b. Foreign Source Income
- c. Deductions

There are a strict set of rules that govern the determination of whether income finds its source in the United States or a foreign place for U.S. tax purposes.

Source of Income

1. Compensation for personal services. The source of income from the personal services is located at the place where the services are performed.
2. Rents and Royalties: Rent or royalty income has its source at the location, or place of use, of the leased or licensed property.
3. Real Property Income and Gain: Income and gain from the rental or sale of real estate has its source at the place where the property is situated.
4. Sale of Personal Property: Historically, gain from the sale of personal property has been sourced at the “place of sale” which is generally held to be the place where title to the goods passes; however, the rules have become more complex taking other factors in place.

Source of Income

5. Interest. The source of interest income is generally determined by reference to the residence of the debtor; interest paid by a resident of the United States constitutes U.S. source income, while interest paid by foreign residents is generally foreign-source income.
6. Dividends. The source of dividend income generally depends on the nationality or place of incorporation of the corporate payer; that is, distributions by U.S. corporations constitute domestic-source income, while dividends of foreign corporations are foreign-source income. There are, however, several important exceptions to these rules.

Source of Income

7. Partially Within and Partially Without. There is a set of source rules that consider the sources of income that can be partially earned in the U.S. and partially from foreign sources such as income from transportation services rendered partly within and partly without the United States; income from the sale of inventory property "produced", "created", "fabricated", "manufactured", "extracted", "preserved", "cured", or "aged" without and sold within the United States or vice versa, and several other types of income. Generally, this is done on some type of allocation basis between the source countries.

Source of Deductions

The source rules for deductions are considerably less specific than those dealing with gross income.

The rules regarding claiming deductions against U.S. income earned by a Foreign Taxpayer merely provide that taxable income from domestic or foreign sources is to be determined by properly apportioning or allocating expenses, losses, and other deductions to the items of gross income to which they relate.

THE EFFECT OF BILATERAL TREATIES - EXTREMELY IMPORTANT BENEFITS

Tax treaties between the U.S. and other countries can operate to;

1. reduce (or even eliminate) the rate of U.S. tax on certain types of U.S. income derived by Foreign Taxpayers situated in the treaty-partner country;
2. override various statutory source of income rules
3. exempt certain types of income or activities from taxation, by one or both treaty-partner countries; and
4. extend credit for taxes levied by one country to situations where the domestic law would not so provide.

THE BRANCH PROFITS TAX

A tax on Foreign Corporations (generally not treaty corporations) that taxes the annual un-invested cash of a foreign corporation that represents earnings and profits.

Foreign Corporation

Net profit Before U.S. Taxes	\$1,000,000
3% City Income Tax	(30,000)
5% State Income Tax	(48,500)
21% Federal Income Tax	(195,720)
30% U.S. Branch Tax	(217,734)

NET PROFITS

\$ 508,046

(CORPORATE EXAMPLE)

“United States Taxation of Foreign Investors”

There are a multiplicity of tax strategies that can be used to make the most of all worlds.

Available Entities

Individual Ownership

ADVANTAGE

- 10% - 37% Individual Income Tax
- 20% max income tax rates certain income
- Capital Gains Tax Rates 10-20%
- No Branch Tax Concern
- Tax only on US Source Income

DISADVANTAGE

- Estate Tax Applies
- Gift Tax Applies
- Unlimited Personal Liability
- Disclosure of Ownership
(*Real Estate Records*)

Available Entities

Limited Liability Company

ADVANTAGE

- 10% - 37% Individual Income Tax
- 20% max income tax rates certain income
- Tax only on US Source Income
- Capital Gains Tax Rates 10-20% Max
- No Branch Tax Concern
- Limited Personal Liability
- No Disclosure of Ownership

DISADVANTAGE

- Estate Tax Applies
- Gift Tax Applies to transfer of certain interests

Available Entities

Partnership

ADVANTAGE

- 10% - 37% Individual Income Tax
- 20% max income tax rates certain income
- Tax only on US Source Income
- Capital Gains Tax Rates 10/20% Max
- No Branch Tax Concern
- Limited Personal Liability
- No Disclosure of Ownership, except at income tax filing level.

DISADVANTAGE

- Estate Tax Applies
- Gift Tax Applies to transfer of certain interests

Available Entities

U.S. Corporation

ADVANTAGE

- 21% Corporate Tax Rates
- No Branch Tax
- No Gift Tax on Transfer of Shares
- Limited Personal Liability
- No Disclosure of Ownership
- Inexpensive Separate Tax Entity

DISADVANTAGE

- Capital Gains Taxed as Ordinary Income 21%
- Dividend and/or Interest Tax (Double Tax)
- Estate Tax/ Not Gift Tax

Available Entities

Foreign Corporation

(Not w/Tax Treaty Country)

ADVANTAGE

- Max 21% Corporate Tax Rates or lower
- No Estate Tax on Death
- No Gift Tax on Transfer of Shares

DISADVANTAGE

- Capital Gains Taxed
- Taxed as Ordinary Income
- Dividend and/or Interest Tax (Double Tax) w/ Distributions
- Branch Tax w/No Distributions
- Expensive Separate Tax Entity

Available Entities

Foreign Corporation

(With Tax Treaty Country)

ADVANTAGE

- Max 21% Corporate Tax Rates or lower
- No Estate Tax on Death
- No Gift Tax on Transfer of Shares
- Generally No Branch Tax
- Reduced Tax on Dividends
- Reduced Tax on Interest
- Limited Personal Liability
- No Disclosure of Ownership

DISADVANTAGE

- Capital Gains Taxed
- Taxed as Ordinary Income
- Expensive Separate Tax Entity

Available Entities

Tiered Corporate

ADVANTAGE

- Max 21% Corporate Tax Rates or lower
- No Estate Tax on Death
- Flexibility for Income Tax Planning
- No Gift Tax on Transfer of Shares
- No Branch Tax
- No Disclosure of Interests

DISADVANTAGE

- Expensive Separate Tax Entity
- Capital Gains Taxed
- Dividend/Interest Tax (Double Tax)

The Individual Foreign Investor – The Problem of the Estate Tax

*There are many exceptions to this general rule
but it is still the general rule.*

- The United States Estate tax is so onerous that the individual Foreign Investor will generally not want to assume the risk of his or her estate having to pay the United States a large tax on the death of the individual foreign owner.

The Individual Foreign Investor - The Problem of the Estate Tax

- The Estate tax may not be a factor if one of the exceptions applies.
 - For example, if the Foreign Investor is from a country with whom the United States has an Estate Tax Treaty, the U.S. estate tax may not apply to that foreign individual.
 - If the individual Foreign Investor is from a country that has its own high estate tax, then the U.S. estate tax may not be of concern because it can be credited against the Foreign Investor's estate tax to his or her own country, so that there is no double estate tax.

Tax Planning Opportunities

Corporate Liquidations

- The principal tax planning tool of the use of the Foreign Corporation that owns a U.S. corporation to own its U.S. assets is to make sure that when the United States real estate is sold by the U.S. Corporation, that U.S. Corporation must be liquidated after the sale.
 - In this fashion only one single U.S. tax is paid at the U.S. corporation level. The proceeds of sale may be transferred free of tax by the U.S. corporation after it has paid its U.S. tax if it is liquidating after the sale.
 - Often one Foreign Corporation may be used as a holding company and will set up several U.S. corporations to own different projects. That way each U.S. Corporation may be liquidated on a deal by deal basis, leaving the Foreign corporation in place.

Portfolio Loans

Another often used tax planning tool is known as the "Portfolio Loan".

- As a general rule a Foreign Corporation or a U.S. Corporation will be able to deduct as a business deduction all of the expenses of that ownership, which include the payment of interest on loans made to acquire U.S. Assets.
- As a general rule, loans made by a Foreign Investor to his or her own Foreign Company, U.S. Company or Limited Liability Company will be deductible by the company.

*** However, the payment of such interest to the Foreign Owner of the company may be subject to a tax as high as 30% on the gross interest paid to the investing company's foreign shareholder.

Portfolio Loans

There is, however a major exception to this general rule provided in the Internal Revenue Code.

That is that a Foreign Investor who owns less than 10% of a business investment will be able to receive the interest that is deductible by the Foreign Company free of any U.S. tax whatsoever.

- This rule does not work in the event the investor owns 10% or more of the investment or an entity that owns the investment.
- This less than 10% requirement includes interest in the deal owned by certain relatives or related companies of the Taxpayer

Like Kind Exchange Real Estate Only

- Another method used by both Foreigners and Americans alike to grow their U.S. real estate portfolios free of U.S. tax is to make sure of the "Like Kind Exchange Rules".
 - Essentially these rules hold that an investor in U.S. real estate may exchange the U.S. real estate project that they own for a different U.S. real estate project without paying any immediate tax of any gain or profit that may be accrued in the first investment.

The Residency Starting Date

1. Green Card
2. Substantial Presence

Income Tax Planning for a U.S. Taxpayer

- A. Foreign Businesses and Deferral w/15% Tax Rates
- B. U.S. Tool Capital Gains, Tax Free Investments
- C. Deferred Compensation Plans
- D. Personal Deductions

United States Taxation of Foreign Investors



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