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Structuring Foreign Investment in the United States

Inward US investment is typically motivated by the benefits of fiscal transparency, a well-developed political and legal system, economic stability, and the absence of currency controls, as well as the need for privacy, asset protection and minimal worldwide taxation.

1. Introduction

A foreigner wishing to invest in the United States often seeks the benefits of US fiscal transparency, a well-developed political and legal system, economic stability and a lack of currency controls. The same investor also often insists that the investment is structured in a way to afford privacy, asset protection and the minimization of worldwide taxation. This article examines all these issues, as well as reviewing commonly used structures.

2. Privacy and Liability

It is the author's experience that most foreign investors into the United States are concerned about privacy. In order to realize privacy, US assets should be acquired either by a trust or a limited liability company (LLC). LLCs are generally to be preferred over corporations, as they offer greater structuring flexibility and better creditor protection than corporations and, in contrast to a limited partnership (LP), do not require the formation of a second entity to act as the general partner. When an LLC is owned by a foreigner it may often be advantageous to elect to treat the LLC as a "C" corporation for federal income tax purposes.

If a trust is used, it is important to remember that the name of the trustee and the name of the trust must appear on the title of trust assets, such as a recorded deed. The investor should not be the trustee and the trust should have a generic name, for example, "Blue Sky Trust", as "Hung Lee, Trustee" and "Hung Lee Trust" affords the investor no privacy.

If a legal entity is used, a generic name should also be used. However, if the entity engages in business activities in California, it must register with the California Secretary of State.[1] The initial Articles of Incorporation and/or the Certificate of Formation or the Statement of Information, therefore, reveals the identity of the corporate officers or the LLC manager to the world. A possible alternative is to use a two-tier structure, i.e. a California LLC to engage in business and a Delaware LLC to act as the manager of the California LLC. In Delaware, the name of the LLC manager does not have to be disclosed and all that appears on the California form is the name of the Delaware LLC as the manager. However, care should be exercised so that the Delaware LLC is not deemed to be doing business in California, otherwise it must also register.[2]

Corporations, LPs and LLCs provide their individual owners with a liability shield in respect of any liability arising from the assets or the business of the entity.[3] However, LPs and LLCs are not required to maintain certain corporate formalities, such as holding annual shareholders' meetings and maintaining annual minutes, thereby affording creditors fewer bases for "piercing the corporate veil". Interests in LPs and LLCs are not attachable by creditors, thereby making them a more effective asset protection vehicle than corporations.[4] For instance, when a creditor obtains a judgement against an individual who owns an apartment building through a corporation, the creditor can force the debtor to turn over the stock of the corporation, thereby resulting in the loss of all corporate assets.[5] If the debtor owns the apartment building through an LLC or an LP, the creditor's remedy is limited to a charging order, i.e. a court order that places a lien on distributions made from the LLC or the LP.[6]

3. Income Taxation

3.1. NRAs and residence

A person who is colloquially referred to as a "foreigner" in the United States is often denominated as a "non-resident alien" (NRA) for federal income tax purposes. An NRA is defined as either a foreign corporation or a person who is: (1) physically present in the United States for less than 183 days in any given year; (2) physically present for less than 31 days in the current year; (3) physically present for less than 183 days in total in a three-year period, using a weighing formula; and (4), in respect of a foreign person, does not hold a permanent resident status, i.e. a green card or

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1. US: Cal. Corp. Code, sec. 17708.03(a). As non-tax legal issues in the United States are a question of state law, this article references California law where applicable. Unless stated otherwise, the laws of other US states are either very similar or identical.
2. *See* J. Stein, *California Registration Requirements for Foreign LLCs*, Cal. Tax Law. (Summer 2008), for a general discussion of the foreign entity registration requirements in California.
3. *See Erkenbrecher v. Grant*, (1921) 187 C. 7, 9, 200 P. 641; *Hollywood Cleaning & Pressing Co. v. Hollywood Laundry Service*, (1932) 217 C. 124, 129; and sec. 17703.04(a)(2) Cal. Corp. Code.
4. Secs. 15907.03(a) and 17704.07(f) Cal. Corp. Code. *See also* J. Stein, *A Practical Take on Charging Orders*, Bus. Ent. Mag. (Sept. 2006), for a general discussion of the charging order limitation.
5. US: Cal. Unif. Com. Code, sec. 8112.
6. Sec. 17705.03(f) Cal. Com. Code.

an EB-5 visa.[7] A foreigner receiving a green card becomes a US tax resident from that day onwards. A foreigner, who is deemed to be a US tax resident based on the number of days test, is deemed to be a US tax resident for the entire calendar year in which the test is met.

A foreigner may be deemed to be a US resident, based on one of the foregoing tests, and also a resident of the home country. In order to avoid double taxation, most tax treaties incorporate a tie-breaker provision regarding residency. The tie-breaker is a hierarchy of three to five tests, with the place of permanent abode as the major factor. For instance, article 4(4) of the United Kingdom-United States Income Tax Treaty (2001)[8] states that, if an individual is deemed to be a resident of both the United Kingdom and the United States, he is a tax resident of the state in which he has a permanent home and, if he has a home in both states, the state in which he has habitual abode and, if he has habitual abode in both, the state in respect of which he holds citizenship and, if in both, the tax authorities of both the states must reach a mutual agreement to decide the issue of residence. If no mutual agreement is reached, a dual national must rely on the availability of the foreign tax credit.[9]

3.2. Withholding on FDAP income

The income tax rules for NRAs can be quite complex. As a general rule, an NRA pays a flat 30% tax on US-source "fixed or determinable, annual or periodical" (FDAP) income that is not effectively connected to a "U.S. trade or business",[10] and which is subject to tax withholding by the payor.[11] The rate of tax may be reduced by an applicable tax treaty to anywhere between 0% and 15%. The income is taxed on a gross basis, with almost no offsetting deductions.

FDAP income includes dividends, interest royalties, rents, annuity payments and alimony. For instance, if an NRA receives interest income from US sources, other than interest on bank deposits, it is subject to a 30% tax. It should be noted that the NRA is subject to this tax, but does not pay it. The 30% FDAP tax is withheld by the payor at the time of payment and remitted to the US Treasury. The NRA receives the remaining 70%. The obligation to withhold is imposed on the person or entity making the payment to the NRA and, if such a payor fails to withhold, it is liable to the Internal Revenue Service (IRS) for the tax, and applicable penalties and interest.

A popular planning tool to avoid withholding tax on interest is to use the portfolio interest rules. Portfolio interest is interest payable only to a foreigner on a debt instrument. It is not subject to taxation or withholding.[12] NRAs often try to comply with the portfolio interest rules by lending through equity participation loans or loans with "equity kickers".[13] These provisions usually increase interest rates on a contingent basis to mimic equity participation. Be aware, however, that in two cases the IRS has successfully argued that such "loan" structures were, in reality, equity investments, thereby producing income subject to taxation and withholding.[14]

3.3. Capital gains

NRAs are generally not taxable on their capital gains from US sources, unless: (1) the NRA is present in the United States for more than 183 days; (2) the gains are effectively connected to a "U.S. trade or business"; or (3) the gains are derived from the sale of certain timber, coal or domestic iron ore assets. If these exceptions apply, the NRA is taxed on US-source capital gains at a rate of 30%.[15]

3.4. Business income

An NRA is taxed on income effectively connected to a "U.S. trade or business" under the same rules as all other US taxpayers. Income may be reduced by appropriate deductions, i.e. connected to the "U.S. trade or business", and the standard tax rates apply.[16]

There is no tax definition of the term "U.S. trade or business". However, the term "U.S. trade or business" has been held to include providing personal services in the United States, selling products in the United States, directly or through an agent (*see* subsequently), soliciting orders from the United States and then exporting merchandise outside the United States, manufacturing, maintaining a retail store, and maintaining corporate offices in the United States. The amount of the commercial activity is not as important as the fact that the NRA was active in the United States and the level of activity was "considerable, continuous, and regular".[17] The "U.S. trade or business" must be of an active nature and not a mere passive investment or ownership of property.[18]

Income is divided into two categories to test whether or not it is "effectively connected". The first category, under section 864(c)(2) of the Internal Revenue Code (IRC), covers FDAP income, portfolio interest and capital gains from assets located in the United States. Such income is

7. US: Internal Revenue Code (IRC), sec. 7701(b)(1)(A). All IRC references are to the Internal Revenue Code of 1986, as amended.
8. *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains* (as amended through 2002) (24 July 2001), Treaties IBFD.
9. Sec. 901 IRC.
10. Id., at secs. 871(a) and 881. Rental income is sourced to where the property is located (id., sec. 861(a)(4)).
11. Id., at sec. 1441(a).
12. Id., at secs. 871(h) and 881(c)(1).
13. An equity kicker is an addition to a fixed-income security, such as a loan, that allows the lender to participate in equity appreciation. This may be accomplished in the form of a conversion option, thereby allowing the lender to convert debt into equity.
14. *See*, for example, *Farley Realty Corp. v. Comm'r.*, 279 F2d 701 (2d Cir. 1960) and *Portage Plastics Co. v. U.S.*, 470 F2d 308 (7th Cir. 1972).
15. Sec. 871(a)(2) IRC.
16. Id., at secs. 871(b) and 882.
17. *See Linen Thread Co. Ltdv.Commissioner of Internal Revenue*, 14 T.C. 725 (T.C. 1950), at 734.
18. *See Continental Trading, Inc. v. Comm'r.*, 265 F.2d 40, 43 (9th Cir. 1959), cert. denied, 361 U.S. 827 (1959); *Neill v. Comm'r.*, 46 B.T.A. 197 (1942) (a building leased on a net basis not a business); and *Aktiebolaget Separator v. Comm'r.*, 45 B.T.A. 243, 249-250 (1941), aff'd per curiam by unpub. op., 128 F.2d 739 (2d Cir. 1942), cert. denied, 317 U.S. 661 (1942) (the mere collection of dividend income does not constitute a trade or business).

deemed to be effectively connected to a "U.S. trade or business" if it meets either the "asset-use" test or the "business-activities" test.

Under the asset-use test, an asset is deemed to be "used" in a trade or business if the asset is needed in that trade or business. For instance, a business maintains a large cash reserve to cover payroll. As the cash reserve is needed to operate the business, the cash reserved is deemed to be used in the business and the interest on that reserve is FDAP, and, therefore, effectively connected. The result is that the interest on the cash reserve being taxed at regular US income tax rates.

The business-activities test considers whether or not the activity that generated income was a material factor in the realization of income of that trade or business. The business activities test is primarily used for passive assets, as such assets are not themselves often critical to the operation of a business. For instance, a foreigner carries on an active trade or business in the United States and then invests the profits in deeds of trust. The interest income from the deeds of trust is not related to the "U.S. trade or business" and is, therefore, not effectively connected.

All other types of income, i.e. the second category, not being FDAP, portfolio interest or capital gains, are automatically "effectively connected" under the "force of attraction" rule as set out in section 864(c)(3) of the IRC. Under this rule if an NRA has a "U.S. trade or business", all US-source income, other than FDAP, portfolio interest or capital gain, is deemed effectively connected to a "U.S. trade or business". This is true even if the US-source income has absolutely no connection to the "U.S. trade or business". The NRA is deemed to be engaging in a "U.S. trade or business" for the year if it was engaged in such a business at any time during that year.

Example

Pierre, a French citizen and resident, manufactures and sells chocolates in the United States. By virtue of that business, he is engaging in a "U.S. trade or business". On weekends, Pierre bakes croissants in his Paris apartment and sells them on the internet. It is a business entirely unrelated to the chocolate business. He has US customers who place orders for chocolates over the Internet. The US Internet croissant orders generate US-source income that, under the force of attraction rule, is effectively connected to Pierre's US chocolate business.

An NRA is engaged in a "U.S. trade or business" if the NRA is a general or limited partner in a US partnership engaged in a trade or business.[19] Similarly, a beneficiary of a US estate or trust is engaged in a "U.S. trade or business" if the estate or trust is so engaged.[20]

An often overlooked stumbling block is the attribution of a "U.S. trade or business" to an NRA through an agent.[21] This involves the following conjunctive three-part analysis: (1) does the NRA have an agent in the United States, i.e. is there an agent-principal relationship; (2) are the activities of the agent attributable and/or imputed to the principal; and (3) is the agent engaging in a trade or business in the United States, the same as the "U.S. trade or business" test discussed previously?

The agency relationship is deemed to exist when the US agent is "dependent" and: (1) has the authority, which he regularly exercises, to conclude contracts in the name of the foreign principal; or (2) carries inventory that belongs to the foreign principal from which orders are regularly filled.[22]If an agency relationship exists, the US Treasury Regulations provide further that the agent's office or fixed place of business maybe be deemed to be an office or fixed place of business of the foreign investor.[23]

An agent is deemed independent if he is a general commission agent or broker, acting independently of the principal and in the ordinary course of his own business.[24]A truly independent agent has his own business, acts on behalf of multiple clients[25]and does not receive detailed instructions from the principal. The fact that the agent and the principal are related, for example, through common ownership or a parent-subsidiary structure, is ignored in testing for the agent's independency.[26]

3.5. Branch profits tax

If a foreign corporation owns a US corporation, there are two levels of tax. First, the US corporation is subject to regular income tax on its profits and there is a 30% withholding tax on dividends paid to the foreign parent, subject to possible treaty reduction. Second, if the same business is operated with just a foreign corporation, i.e. the US operation is an unincorporated branch, there is no dividend originating in the United States and no withholding tax. In order to eliminate this disparity and to subject foreign corporations operating through a US branch to a double tax, i.e. a tax on earnings and tax on dividends, the US Congress enacted section 884 of the IRC, which imposes a branch profits tax.

The branch profits tax applies at the rate of 30%, i.e. the same as the withholding tax on dividends,[27] but may be reduced by an applicable tax treaty. The United States has tax treaties covering the branch profits tax with most European nations, thereby reducing the tax to between 0% and 10%, usually to the same rate which dividends would be subject to under the same tax treaty. Qualifying for treaty benefits is difficult, as the foreign corporation must establish that it is not "treaty shopping", i.e. meaning it is organized in the treaty state for a purpose other than tax avoidance. In other words, the corporation's shareholders are

19. Sec. 875(1) IRC.
20. Id., at sec. 875(2).
21. *See Spermacet Whaling & Shipping Co. SA v. Comm'r.*, 30 TC 618 (1958), aff'd 281 F2d 646 (6th Cir. 1960).
22. US: Treas. Reg., sec. 1.864-7(d)(1)(i).
23. Id., at sec. 1.864-7(d).
24. Id., at sec. 1.864-7(d)(3)(i). *See also OECD Model Tax Convention on Income and on Capital*, art. 5(6) (11 Apr. 1977), Models IBFD and *OECD Model Tax Convention on Income and on Capital*, art. 5(6) (1 Sept. 1992), Models IBFD.
25. The US Tax Court (TC), in US: TC, 2 May 1995, *Taisei Fire and Marine Company, Ltd. v. Comm'r.*, 104 TC 535 (1995), Tax Treaty Case Law IBFD, held that an agent is independent if he represents four principals who do not act jointly to control the agent.
26. Treas. Reg. sec. 1.864-7(d)(3)(ii).
27. Id.

resident in the treaty state, it does not distribute most of its income out of the treaty state or it is engaging in an active trade or business in the treaty state.

The 30% tax applies to a "dividend equivalent amount",[28] which is the foreign corporation's effectively connected earnings and profits for the year, less investments that the corporation makes in its US assets, i.e. money and adjusted bases of property connected with the conduct of a "U.S. trade or business". Money is only counted to the extent that it is necessary to meet the operating expenses of the US business.

If the equity of the "U.S. trade or business" falls for the year, meaning that the foreign corporation divested from the United States, the earnings and profits are increased by such a reduction, but subject to specified limitations, in calculating the dividend equivalent amount. Actual distributions made by the foreign corporation to its shareholders do not reduce the dividend equivalent amount, but, if the dividend itself is distributed in the same year when the foreign corporation pays a branch profits tax, the dividend may escape the 30% withholding tax.[29]

Example

Bermuda Inc. has USD 100 of effectively connected earnings and profits for the year. At the beginning of the year it had US assets of USD 500 and liabilities of USD 200, thereby resulting in USD 300 of equity in its US business. At the end of the year, Bermuda Inc. has USD 600 of assets and USD 250 of liabilities, thereby resulting in USD 350 of equity. The dividend equivalent amount is USD 50, calculated as USD 100 of earnings and profits reduced by the USD 50 increase in equity.

If a foreign corporation completely terminates its US business, it is not subject to the branch profits tax for that year.[30] As a planning point, if a foreign investor is planning on operating several US businesses that generate little or no earnings and profits, such as depreciable real estate, it would make sense to form several foreign corporations, with each foreign corporation operating a separate branch. For instance, if a foreign investor acquires two US apartment buildings through a foreign corporation, on the sale of one building, there may be a branch profits tax, as the resulting cash is not necessary for the continued operation of the "U.S. trade or business". If two separate corporations owned two buildings, on the sale of one of the buildings, the foreign corporation that is the seller would terminate its US business and would not be subject to the branch profits tax.

3.6. FIRPTA

As if the preceding simplified summary (*see* sections 3.1. to 3.5.) is not complicated enough to confound most practitioners, rules applicable to the tax on the disposition of real estate are to be found in a separate regime known as the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).[31] Generally, FIRPTA taxes the disposition of a US real property interest (USRPI)[32] as if the NRA were engaged in a "U.S. trade or business".[33] This means that the traditional income tax rules that apply to US taxpayers also apply to the NRA. Purchasers who acquire a USRPI from an NRA must withhold 10% of the amount realized on the disposition.

An interest in real property includes any ownership of land, buildings, mineral deposits, crops, fixtures, personal property used to: (1) exploit natural resources; (2) construct improvements; (3) operate a lodging facility; or (4) provide a furnished office to a tenant, such as movable walls or furnishings, improvements, leaseholds, or options to acquire any of the foregoing.[34] Ownership interests include fee ownership, co-ownership, leasehold, a timeshare, a life estate, a remainder, a reversion, or a right to participate in the appreciation of real property or in the profits from real property.[35]

A partnership interest is treated as a USRPI if: (1) 50% or more of the value of partnership gross assets consists of USRPIs; *and* (2) 90% or more of the value of partnership gross assets consists of USRPIs plus cash and cash equivalents.[36] The disposition of such partnership interest is subject to FIRPTA to the extent that the partnership owns USRPIs and is subject to withholding.

A domestic corporation is treated as a US Real Property Holding Corporation (USRPHC) if USRPIs equal or exceed 50% of the sum of such a corporation's USRPIs, foreign real estate and trade and business assets.[37] The disposition of an interest in a USRPHC is subject to the FIRPTA tax and withholding, but is not subject to state income tax.[38] This should be contrasted with the disposition of a USRPI owned directly, which is subject to the lower federal capital gains rate, but is also subject to the state income tax.

The disposition of an interest in a domestic corporation is not subject to these rules if, on the date of the disposition, the corporation had no USRPIs and all of the gain was fully recognized, i.e. no instalment sales or exchanges, on the sale of any USRPIs sold within the past five years.[39]

Any NRA, i.e. an individual or a corporation, selling a USRPI is subject to withholding of 10% of the amount realized. Withholding applies even if the property is sold at a loss.[40] The withholding obligation is imposed on the purchaser, who must report the withholding and pay over the tax using Form 8288 within 20 days of the purchase. If the purchaser fails to collect the withholding tax from

28. Sec. 884(a) IRC.
29. Id., at sec. 884(e)(3)(A).
30. Treas. Reg., sec. 1.884-2T(a)(1).
31. FIRPTA is codified in sections 897, 1445 and 6039C of the IRC.
32. A USRPI is defined as any interest in: (1) real property located in the United States; or (2) a domestic corporation that is a "United States real property holding corporation" (sec. 897(c)(1) IRC).
33. Sec. 897 IRC.
34. Sec. 897(c) IRC and Treas. Reg., sec. 1.897-1(b).
35. Treas. Reg., sec. 1.897-1(d)(2)(i).
36. Id., at sec. 1.897-7T.
37. Sec. 897(c)(2) IRC.
38. Id., at sec. 897(a)(1). There are no state law equivalents to FIRPTA and, under state law, a sale of an interest in a domestic corporation, even if it is a USRPHC for federal income tax purposes, by a foreigner is not taxable, following the general rule of section 892 of the IRC.
39. Sec. 897(c)(1)(B) IRC and Treas. Reg., sec. 1.897-2(c).
40. Sec. 1445 IRC.

the foreigner, the purchaser is liable for the tax, plus any applicable penalties and interest. The withheld taxes are later credited against the total tax liability of the foreigner.

Withholding is not required if: (1) the seller provides a certificate of non-foreign status; (2) the property acquired by the purchaser is not a USRPI; (3) the transferred property is stock of a domestic corporation and the corporation provides a certificate that it is not a USRPHC; (4) the USRPI acquired is used by the purchaser as a residence and the amount realized by the foreigner on the disposition is USD 300,000 or less; (5) the disposition is not subject to tax, i.e. a tax-free exchange; or (6) the amount realized by the foreigner on the disposition is zero.[41]

4. Estate and Gift Tax

For estate tax purposes, the test is completely different in determining who is an NRA. For this tax, the inquiry centres on the decedent's domicile.[42] This is a more subjective test that looks primarily at intent[43] and also considers factors such as the length of stay in the United States and the frequency of travel, size and cost of home in the United States, the location of family, the participation in community activities, the participation in a US business, and the ownership of assets in the United States and voting.

A foreigner can be a US resident for income tax purposes, but not be domiciled for estate tax purposes. For simplicity, in explaining the estate and gift tax considerations, this article refers to foreigners who are both NRAs and not domiciled in the United States as NRAs.

An NRA is subject to a different transfer tax, i.e. estate and gift taxes, regime than a US taxpayer. Estate tax is imposed only on the part of the NRA's gross estate that, at the time of death, is situated in the United States[44] The rate of an NRA's estate tax is the same as that imposed on US citizens and resident aliens, but the unified credit is only USD 13,000, which is equivalent to approximately USD 60,000 of property value.[45] These harsh rules may be ameliorated by an estate tax treaty. The United States has not concluded as many estate tax treaties as tax treaties in general, but there are estate tax treaties in place with most Western European countries, for example, the United Kingdom-United States Inheritance and Gift Tax Treaty (1978),[46] and countries in the Asia-Pacific region, for example, the Australia-United States Gift Tax (1953)[47] and the Japan-United States Inheritance and Gift (1954)[48] Tax Treaties.

The various assets are specifically included by the IRC in the definition of property situated in the United States. These assets are: (1) shares or stock of a US corporation; (2) revocable transfers or transfers within three years of death of US property or transfers with a retained interest;[49] and (3) debt issued by a US person or a governmental entity within the United States, for example, municipal bonds.[50]

US-situs property also includes real estate in the United States, if debt is recourse, it is ignored and the gross value is included and not just the equity, and tangible personal property, such as works of art, furniture, cars, and even currency in a safety deposit box.[51] In addition, beneficial interest in a trust holding US property is US-situs property.[52] US-situs property does not include life insurance proceeds paid on the life of the NRA, bank accounts, unless connected to a US business, portfolio interest loans[53] and shares of stock in a foreign corporation.[54]

The gross estate is reduced by various deductions relating to the US-situs property. The estate tax returns must disclose all of the NRA's worldwide assets so as to determine the ratio that the US assets bear to non-US assets. This ratio determines the percentage of allowable deductions that may be claimed against the gross estate.[55]

When real estate is subject to a recourse mortgage, the gross value of the real estate is included, offset by the mortgage debt.[56] This distinction is irrelevant for US taxpayers filing estate tax returns, but is very relevant for NRAs for whom debts are subject to apportionment between US and non-US assets, and, therefore, not fully deductible.[57]

Advance planning can eliminate or reduce the US estate tax obligations of NRAs. For instance, US real estate owned by the NRA through a foreign corporation is not included in an NRA's estate. This effectively converts US real property into a non-US intangible asset. Even if the real property was not initially acquired through a foreign corporation, it may be beneficial to pay income tax currently on the transfer of the real estate to a foreign corporation, usually treated as a sale, to avoid the estate tax in the future.

Gift taxes are imposed on the donor. An NRA donor is not subject to US gift taxes on any gifts of non-US-situs prop-

41. Sec. 1445 IRC and Treas. Reg., sec. 1.1445-2(d)(2)(i).
42. Treas. Reg., sects. 20.0-1(b)(1), 25.2501-1(b).
43. For instance, if the foreigner was in the United States on a non-immigrant visa, as opposed to an immigrant visa, that would support lack of intent to make the United States a permanent domicile.
44. Sec. 2103 IRC.
45. Id., at sec. 2102(b)(1).
46. *Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts* (19 Oct. 1978), Treaties IBFD.
47. *Convention between the Government of the United States of America and the Government of the Commonwealth of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Gifts* (14 May 1953), Treaties IBFD.
48. *Convention between the United Stated of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances and Gifts* (16 Apr. 1954), Treaties IBFD.
49. Secs. 2035 to 2038 IRC.
50. Id., at sec. 2104.
51. Treas. Reg., sec. 20.2104-1(a).
52. I.R.S. Rev. Rul. 55-163, 1955-1 C.B. 674, Administrative Documentation IBFD.
53. Sec. 2105 IRC.
54. Treas. Reg., sec. 20.2105-1(f).
55. Sec. 2105(a)(1) and (2) IRC.
56. Treas. Reg., sec. 20.2053-7. If the mortgage is non-recourse, only the net value of the property is included in the estate.
57. Id., at sec. 20.2106-2. Apportionment is possible only if worldwide assets are disclosed on the estate tax return.

erty to any person, including US citizens and residents. US citizens and residents must report gifts from an NRA, in excess of USD 100,000 on Form 3520.[58]

Gifts of US-situs assets are subject to gift taxes, with the exception of intangibles, which are not taxable.[59] Tangible personal property and real property is sited within the United States if it is physically located in the United States.[60] NRA donors are allowed the same annual gift tax exclusion as other taxpayers and are subject to the same rate schedule for gift taxes. However, the lifetime unified credit is not available to NRA donors.[61] The primary thrust of estate tax planning for NRAs is, therefore, through the use of: (1) foreign corporations to own US assets; or (2) the gift tax exemption for intangibles to remove assets from the United States.

If the NRA dies owning shares of stock in a foreign corporation, the shares are not included in the NRA's estate, regardless of the situs of the corporation's assets. It is important that the corporation has a business purpose and activity, lest it be deemed a sham designed to avoid US estate taxes.[62]

The gift of an intangible, wherever situated, by an NRA is not subject to gift tax. Shares in US corporations and interests in partnerships or LLCs are intangibles.[63] Consequently, real estate owned by the NRA through a US corporation, partnership or an LLC may be removed from the NRA's US estate by gifting entity interests to foreign relatives free of gift tax.

5. Ownership Structures for Foreign Investors

An NRA can acquire US assets using several alternative ownership structures. The NRA's goals and priorities dictate the type of structure that is used. Each alternative has its own advantages and disadvantages, i.e. there is no perfect structure.

Direct investment, i.e. assets owned by the NRA, is simple and is subject to only one level of tax on the disposition. If the asset is held for one year, the sale is taxed at a 15% rate.[64] The disadvantages of direct investment are: (1) no privacy; (2) no liability protection; (3) the obligation to file US income tax returns; and (4), if owned on death, the US asset is subject to US estate taxes.

Under an LLC and/or an LP structure, the NRA acquires the US asset through an LLC or an LP. The LLC may be a disregarded entity or a tax partnership for US income tax purposes. This is an improvement over the direct ownership alternative, as this structure provides the NRA with privacy and liability protection and allows for lifetime transfers that escape the gift tax. The obligation to file US income tax returns and the possibility of liability to US estate tax on death, however, remains.

Ownership of US assets through a domestic corporation, in which case the corporation is always a "C" corporation, as a foreign shareholder precludes an "S" corporation,[65] affords privacy and liability protection, allows lifetime gift tax-free transfers and obviate the foreigner's need to file US income tax returns. Engaging in a "U.S. trade or business" requires a US tax return, but ownership of stock does not give rise to a return filing obligation.

The disadvantages to the ownership of US assets through a domestic corporation are: (1) federal and state corporate income tax at the corporate level adds a second layer of tax; (2) dividends from the domestic corporation to its foreign shareholder are subject to 30% withholding; and (3) the shares of the domestic corporation are included in the US estate of the foreign shareholder. If the corporation owns primarily real estate in the United States, on the disposition of the stock in the corporation, the foreign shareholder is subject to FIRPTA, as the corporation is treated as a USRPHC (*see* section 3.6.). This requires the filing of a US income tax return and 10% tax withholding by the purchaser of the shares.

Ownership of the US assets may be by the US corporation directly or through a US partnership or disregarded entity owned by the corporation. The corporation may even be an LLC that "checks-the-box" to be taxed as a corporation. In turn, the ownership of the US corporation by the NRA may be direct or through a foreign partnership or disregarded entity.

Foreign corporation ownership offer the following advantages: (1) liability protection; (2) no US income tax or filing requirement for the foreign shareholder; (3) shares in the foreign corporation are non-US assets that are not included in a US estate; (4) dividends are not subject to US withholding; (5) no tax or filing requirement on the disposition of the stock; and (6) no gift tax on the transfer of shares of stock. The disadvantages of using the foreign corporation are: (1) corporate level taxes, i.e. just as with the domestic corporation, as the foreign corporation may be deemed to be engaged in a "U.S. trade or business"; and (2) the foreign corporation is subject to the branch profits tax, which is the biggest disadvantage of ownership of US real estate through a foreign corporation.

As the branch profits tax is often not reduced or eliminated by a tax treaty, the most advantageous structure for the ownership of US assets by NRAs is through the foreign corporation-US corporation structure. Here, the NRA owns a foreign corporation which in turn owns a US LLC taxed as a corporation. This structure affords privacy and liability protection, has no US income tax filing requirements, avoids US estate taxes, allows for gift tax-free lifetime transfers and avoids the branch profits tax. Distributions from the US subsidiary to the foreign parent are

58. I.R.S. Notice 97-34, 1997-1 CB 422, Administrative Documentation IBFD.
59. Sec. 2501(a)(2) IRC.
60. Treas. Reg., sec. 25.2511-3(b).
61. Sec. 2505(a) IRC.
62. *See*, for example, *Jackson v. Comm'r.*, 233 F. 2d 289 (2d Cir. 1956).
63. For a partnership, the interest is an intangible if the partnership is a distinct legal entity and survives the death of its partners, *see Sanchez v. Bowers*, 70 F. 2d 715 (2d Cir. 1934). For the application of this rule to an LLC, *see Pierre v. Comm'r*, TC Memo 2010-106.
64. Sec. 1(h) IRC.
65. Id., at sec. 1361(b)(1)(C).

subject to the 30% FDAP withholding, but the timing and the amount of such dividend is within the NRA's control.

6. Pre-Immigration Tax Planning

When a foreign individual intends to become a US taxpayer, either by spending sufficient time in the United States or obtaining a permanent residence visa, he should plan in advance to deal with the inevitable worldwide income taxation by the United States and the eventual US estate to be imposed on his worldwide assets. Income tax planning for a would-be immigrant includes: (1) accelerating recognition of foreign-source income, as only income recognized following date of US residence may be taxed by the United States; (2) disposing of appreciated assets in a taxable transaction to establish a higher tax basis, which may, for example, include the sale of the assets to a spouse who remains an NRA, the liquidation of a foreign holding company, which is then deemed to have sold all of its assets for cash, or a deemed liquidation of the foreign company by electing to classify an existing foreign corporation as a disregarded entity for US tax purposes; (3) deferring recognition of loss or use of deductible expenses; (4) receiving a distribution of all earnings and profits from any foreign corporation that is later deemed to be a controlled foreign corporation (CFC); (5) investing in US tax compliant annuities or life insurance policies, as such investments are not subject to US income tax; and (6) establishing a pre-immigration foreign, non-US, trust.

A pre-immigration foreign trust is used both for income and estate tax planning for an immigrant. If properly structured, the assets of the trust are not deemed to be the assets of the trust's settlor. This excludes the income of the trust from US taxation and excludes the assets of the trust from the settlor's estate.[66] The would-be immigrant should also gift foreign assets or US intangibles to foreign or US family members, before such gifts become subject to US transfer taxes.

7. Conclusions

Properly structuring foreign investment in the United States takes into account corporate law, liability protection, privacy and tax planning. The structure is primarily driven by tax considerations, and an incorrect structure can have catastrophic tax results. In addition to the federal tax consequences discussed above, there may also be state income tax issues, which are beyond the scope of this article. Every investor and their professional advisor are strongly encouraged to seek local counsel in the United States for structuring and tax advice.

66. It should be noted that section 679(a)(4) of the IRC states that a trust established by an NRA is treated as a grantor trust if the NRA funds the trust within five years of becoming a US resident. Consequently, the NRA should either have a third-party fund the trust or plan more than five years in advance.