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# *Understanding International Taxation*

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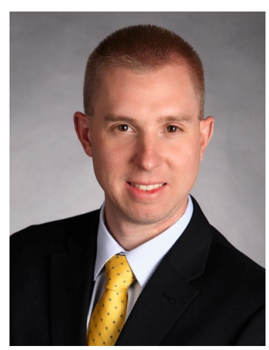

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# *Understanding International Taxation*

## INTRODUCTION



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# *Understanding International Taxation*

## INTRODUCTION

- ***International tax draws a great deal of focus***
  - Accompanied by significant amount of misunderstanding, due to:
    - Incredibly-complex tax code
    - Integration with tax laws, regulations and treaties of foreign countries

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## *Understanding International Taxation*

### INTRODUCTION

- ***Inter-country competition for business and jobs***
  - Results in constantly-changing tax laws (domestic and abroad)
    - Designed to provide competitive advantage to that country
    - Adds to difficulties in assessing statistical information

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### INTRODUCTION

- ***Assessing the U.S. tax system against competitor countries***
  - Statistics can be useful

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### INTRODUCTION

- ***Organization of Economic Co-Operation and Development (OECD)***
  - Approximately 35 member countries
  - Annually publishes on variety of economic data, including taxes



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### INTRODUCTION

- ***OECD statistics***
  - For the OECD countries, collectively, 33.7% of tax collections are based on income (both personal and corporate)
    - 40.0%+ in the United States
    - 15.0% more in state and local taxes

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## INTRODUCTION

- ***Statutory rates***
  - At the center of a great deal of discussion and controversy
  - U.S. corporate rate = 39% (35% federal)
    - 16% higher than worldwide average of 22.8%
    - 3rd highest in 173 countries

Source: Tax Foundation – *International Tax Competitiveness Index 2015*

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## INTRODUCTION

- ***Statutory rates vs. effective rates***
  - The effective rate is about the same
  - However, it is acknowledged that a major statutory rate differential exists

Source: Congressional Research Service whitepaper

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## INTRODUCTION

- ***U.S. tax reform***
  - Likely to result in lower corporate rates
  - Trade-off will be a broader base



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## INTRODUCTION

- ***Challenges of conducting business internationally***
  - Different (lower) tax rates around the world make it difficult for the United States to compete in a global economy
  - Other critical issues include currency selection and exchange rates
  - Varied tax liabilities in differing tax systems
  - Companies must also understand employment needs, business environment mechanics of doing business and cultural differences in a specific jurisdiction

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## Understanding International Taxation

### INTRODUCTION

- ***Challenges of inbound business investments***
  - Transition can be especially difficult for companies from less-sophisticated parts of the world that must comply with broad, complicated U.S. tax system
  - Can also be challenging for both foreign investors and workers

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## Understanding International Taxation

### INTRODUCTION

- ***Organization of program***
  - Fundamentals: International and Individual Taxation Basics
  - Inbound Taxation: Taxation of Foreign Persons, Special Considerations, Filing Requirements
  - Outbound Taxation: Taxation of U.S. Citizens and Businesses, Special Rules for Reporting, Overview of Income Tax Treaties

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## *Understanding International Taxation*

FUNDAMENTALS OF
INTERNATIONAL TAXATION

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## *Understanding International Taxation*

INTERNATIONAL TAXATION BASICS

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# *Understanding International Taxation*

## INTERNATIONAL TAXATION BASICS

- ***Tax implications of Inbound and Outbound transactions make up the U.S. international taxation System***
  - Inbound: taxation of investments and business activity of foreign persons in the United States
  - Outbound: investments and business activity of U.S. persons outside of the United States

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# *Understanding International Taxation*

## INTERNATIONAL TAXATION BASICS

- ***Key Terms***
  - U.S. Person
  - Foreign Person
  - U.S. Citizen
  - Expatriate
  - Resident Alien
  - Nonresident Alien

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## INTERNATIONAL TAXATION BASICS

- ***Inbound System for taxing foreign persons in the United States***
  - U.S.-sourced income not connected with U.S. trade or business
    - Fixed or determinable, annual or periodical (FDAP) income
    - Includes U.S.-sourced interest, dividends, rents, royalties and compensation
    - Taxed at a flat 30% rate on a "gross" basis (no deductions or modifications allowed)
    - Foreign persons may be subjected to graduated tax rates on the disposition of certain real property located in the United States



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## INTERNATIONAL TAXATION BASICS

- ***Inbound System for taxing foreign persons in the United States***
  - Income effectively connected with U.S. trade or business
    - Determination of connectivity based on relevant facts and circumstances (specific and unique to each situation)
    - IRS has not issued rulings on determination procedures
    - Courts may look to the nature of the activities, the level, extent and continuity of the activities, and the time required to perform the activities to determine if income is effectively connected

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### INTERNATIONAL TAXATION BASICS

- ***Outbound system for U.S. persons working in a foreign country***
  - U.S. worldwide taxation system: every dollar earned, regardless of source is reported and subject to U.S. tax
  - Foreign tax credit can be used to avoid double taxation of earnings already taxed in a foreign country
  - Foreign earned income exclusion can further reduce U.S. taxes owed
  - Additional reporting requirements for certain foreign activities

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### INDIVIDUAL TAXATION BASICS

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## INDIVIDUAL TAXATION BASICS

- ***Nationality in taxation***
  - U.S. citizen is subject to worldwide tax
    - Dual status citizenship: taxation may be governed by tax treaty
    - Loss of citizenship: status converts to nonresident alien, but when (or whether) citizenship is lost must be determined

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## INDIVIDUAL TAXATION BASICS

- ***Loss of citizenship***
  - Recent change in rules regarding whether worldwide taxation stops while trying to prove loss of citizenship
    - If government initiates action, U.S. taxation is suspended until resolution is reached
    - If individual brings action, U.S. taxation is not suspended

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## INDIVIDUAL TAXATION BASICS

- ***Expatriation to avoid tax***
  - IRC 877 created to attempt to close this loophole
    - Formula to determine whether move was made for tax avoidance
    - U.S. government can impose tax on expanded income base for 10 years after expatriate's loss of citizenship
  - 30-day rule added in 2004 to modify the process
  - Further provisions for expatriates added in 2008



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## INDIVIDUAL TAXATION BASICS

- ***Residence of individuals***
  - Properly determining taxpayer's residency status critical to determine which rules and regulations apply
  - Resident alien status determined by:
    - Green-card test
    - Substantial-presence test

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### INDIVIDUAL TAXATION BASICS

- ***Substantial-presence test***
  - Foreign national is a resident if remaining in the United States for 183 during the year
    - Time spent in the United States for two prior years can be added (with less weight), but must include 31 days in current year

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### INDIVIDUAL TAXATION BASICS

- ***Substantial-presence test***
  - Individuals with "tax homes" in or "closer connections" to a foreign country may not achieve nonresident alien status, even if substantial-presence test qualifications are met
    - Tax home considered to be place of employment not abode
    - Connection determined based on facts and circumstances

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### INDIVIDUAL TAXATION BASICS

- ***Application of rules***
  - Residency determined by green-card test:
    - Residency status begins on the day taxpayer becomes a lawful resident and continues to end of calendar year, as long as he/she is physically present for one day during period
    - If not present during period, residency status begins on the first day of the following year
    - Residency status ends on last day of presence as lawful resident

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### INDIVIDUAL TAXATION BASICS

- ***Application of rules***
  - Residency determined by substantial-presence test:
    - Residency status begins on the first day of presence for the period
    - Taxpayers can elect to be treated as residence alien for the entire calendar year of their stay
    - Ending date generally last day of presence, following a period when taxpayer is no longer present or has a closer connection to another country (generally December 31 of year of departure)

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## Understanding International Taxation

DETERMINATION OF SOURCE OF INCOME



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## Understanding International Taxation

### DETERMINATION OF SOURCE OF INCOME

- ***Interest***
  - Originates from individual or underlying business activity of entity that remits payment
    - More difficult to determine source of income from partnerships that remit interest payments
    - Rules to determine proper situs of source changed in 2004
    - Corporations source interest payments to the place of incorporation

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### DETERMINATION OF SOURCE OF INCOME

- ***Dividends***
  - Follows same general rule as interest payments
  - Foreign corporations that issue dividend receive U.S.- sourcing if 25% or more of gross income in preceding three years is connected to the United States
  - Amount of U.S.- sourced dividend is adjusted based on ratio of U.S.-sourced income to corporation's entire income for period





## *Understanding International Taxation*

### DETERMINATION OF SOURCE OF INCOME

- ***Compensation for personal services***
  - General rule sources income to location where services were performed
    - Becomes complicated due to technological advances that allow one to work from all around the world

# Understanding International Taxation

## DETERMINATION OF SOURCE OF INCOME

- ***Compensation for personal services***
  - 90-day rule excludes certain compensation from the U.S.
  - Rule considers all compensation earned by foreign person to be foreign-sourced if:
    - Person is present for 90 or fewer days in U.S. during tax period
    - Services are for foreign person not engaged in U.S. business/trade
    - Total compensation does not exceed $3,000



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DETERMINATION OF SOURCE OF INCOME

- ***Rental and royalties***
  - Patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, etc.
  - Can be difficult to work through since intangible property has no specific location and can be used in multiple places
  - IRC 861 attempts to simplify the approach

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### DETERMINATION OF SOURCE OF INCOME

- ***Gains from the sale of property***
  - Real property
    - Includes directly-owned real property and ownership of stock of a domestic corporation that owns an interest in U.S. real property

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## Understanding International Taxation

### DETERMINATION OF SOURCE OF INCOME

- ***Gains from the sale of property***
  - Sale of personal property
    - IRC sources gains from sales of personal property by a citizen and resident alien to the United States
    - Sale of personal property by a nonresident alien is sourced outside the United States
    - Depreciable property that is past depreciation is recovered with same source of income it was used to offset

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***Understanding International Taxation***

UNDERSTANDING
INBOUND TAXATION

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***Understanding International Taxation***

SPECIAL CONSIDERATIONS

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## *Understanding International Taxation*

- ***Specific tax consequences for a "person" who owns an interest in a U.S. business***
- ***What factors are considered in determining how to tax a foreign owner who is doing business in the United States?***

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## *Understanding International Taxation*

- ***Foreign-based "person" with ownership in a U.S. business***
  - Can be an individual
  - Can be a foreign corporation, partnership or some other form of entity
- ***The type of entity formed in the U.S. ultimately determines the tax consequence of the entity and the owner***

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- ***U.S. taxation of individuals who are owners of certain U.S. entities***
  - U.S. corporation with foreign shareholders: taxed the same as a U.S. domestic corporation, at the entity level, at tax rates between 15% and 35%
    - Distributions from U.S. corporations to foreign shareholders will generally have withholding at 30%

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- Foreign corporation: tax treatment similar to that of nonresident alien individual; taxed on ECI at graduated income tax rates (15%-30%)

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- U.S. partnership with foreign partners: if partnership is deemed to be engaged in a trade or business, partners are engaged in a trade or business and will have ECI
  - Tax must be withheld on each foreign partner's applicable percentage of ECI (generally at 30%)
  - ECI is taxed to the partner at U.S. graduated tax rates
  - Withholding from the partnership is applied against tax due, with foreign credits allowed

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- Foreign partnership: if partnership has U.S. ECI, required to file same returns as U.S. domestic partnership
  - Foreign partners with allocable ECI must file U.S. income tax return and pay applicable U.S. income tax

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- ***What about LLCs?***
  - Depends on who owns the LLC
    - If it is owned by an entity, the entity will have ECI
    - If it is owned by an individual, the individual will have ECI



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## Understanding International Taxation

- ***Effectively-connected income (ECI)***
  - Trade or business conducts any regular, substantial and continuous management, production, distribution or other major business function within the United States
  - Requires attention to activities nonresident alien engages in
    - Cannot have ECI unless he or she participated in U.S. trade or business at some point
    - Income taxed in jurisdiction where income is earned

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- ***Effectively-connected income (ECI)***
  - Taxed on net basis at graduated income tax rates
  - Business expenses and itemized deductions are allowed
  - Taxable income computed in same manner as for U.S. persons
  - Nonresident alien is considered to be engaged in a trade or business when he or she performs personal services in the United States

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## Understanding International Taxation

- ***Fixed, determinable, annual or periodical (FDAP) income***
  - Very broad definition; includes many types of income
  - Taxed at flat 30% rate unless treaty provides otherwise; tax payment collected by withholding at the source
  - Examples listed on pages 21-22

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- ***Fixed, determinable, annual or periodical (FDAP) income***
  - Can be considered ECI or not ECI; determination of which will decide how it is taxed
  - FDAP income that is also ECI:
    - Foreign-sourced items can be treated as ECI if nonresident alien has fixed place of business in U.S. to which income is attributable
    - Investment income must meet requirements of asset-use and business-activities tests to determine if ECI

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- ***FDAP income that is also ECI***
  - Asset-use test
    - Usually applied to various passive income items
    - Determines if item of income, gain or loss is derived from assets that are used or held for use in the United States
    - If income is derived from U.S. use of assets, it is ECI

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## Understanding International Taxation

- ***FDAP income that is also ECI***
  - Business-activities test
    - Applied when income, gain or loss (though passive) arises directly from active conduct of U.S. trade or business
    - Items include dividends/interest in stock or securities, gain or loss from sale or exchange of capital assets, royalties on licensing of IP or other intangibles and service fees



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- ***FDAP income that is also ECI***
  - If FDAP income is determined to be ECI, it is taxed in the United States on a net basis, using graduated income tax rates
  - If FDAP income is determined not to be ECI, it is taxed at 30% flat rate (or lower if treaty applies); deductions and netting are not allowed

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## Understanding International Taxation

- ***Income taxation of U.S. persons – Maximum rates***
  - Citizens and resident aliens
    - Ordinary income: 39.6%
    - Long-term capital gains: 20.0%
    - Short-term capital gains: 39.6%
    - Qualified dividend income: 20.0%
  - Corporations
    - Ordinary income and capital gains: 35.0%

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- ***Income taxation of U.S. persons***
  - Worldwide income subject to tax
    - Source of income is irrelevant
    - Character of income is irrelevant

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## Understanding International Taxation

- ***Nonresident aliens***
  - Only taxed on income earned or derived within the U.S.
    - Effectively connected income (ECI), and
    - Fixed, determinable, annual or periodical (FDAP) income is not effectively connected with the conduct of a trade or business; includes interest, dividends, services, rents, royalties, wages, etc.



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- ***Nonresident aliens***
  - Main difference between ECI and FADP income is the rate at which these two categories are taxed
    - ECI will be taxed at a graduated tax rate, ranging from 10%-39.6% depending on the amount of taxable income and entity that generated the taxable income
    - FDAP will have a flat 30% rate

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TAXATION AND FILING REQUIREMENTS FOR RESIDENT AND NONRESIDENT ALIENS

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- ***Taxation of resident aliens***
  - If an individual meets the requirements of the green-card or substantial-presence test, he or she must file U.S. tax return
    - Form 1040, due on April 15

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- ***Taxation of resident aliens***
  - Resident alien's income subject to same rules as U.S. citizen
    - All worldwide income must be reported and is subject to tax
    - Foreign tax credits can be used to avoid double taxation
    - If a resident alien for entire tax year, individual can use the same filing statuses, claim deductions, use exemptions and claim tax credits, using the same rules that apply to U.S. citizens

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- ***Taxation of nonresident aliens***
  - Different taxation rules apply than for resident aliens or citizens
    - Generally subject to U.S. income tax only on U.S.-sourced income
    - Income reported on 1040 NR or 1040NR-EZ
    - Filing due by 15$^{th}$ day of fourth month (April 15) for employees subject to withholding on wages or self-employment income; due 15$^{th}$ day of sixth month (June 15) for all other nonresident aliens

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- ***Taxation of nonresident aliens***
  - Treatment of taxable income taxed depends on category of U.S.-sourced income
    - ECI taxable at same graduated rates as for U.S. Citizens
    - FDAP income taxed at a flat rate with no deductions allowed
  - Foreign-earned income is exempt from U.S. taxation

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## Understanding International Taxation

- ***Taxation of nonresident aliens***
  - All nonresident aliens must file tax return (no minimum income)
  - Filing rules and options different than for U.S. citizens
    - Standard deduction generally not available
    - Single filing status can be used; married-filing-jointly is limited
    - Head-of-household status cannot be used
    - Some alternate filing options are available under special rules

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UNDERSTANDING
OUTBOUND TAXATION



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TAXATION OF U.S. CITIZENS
AND BUSINESSES

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# *Understanding International Taxation*

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Two primary concepts***
  - All worldwide income of U.S. persons working outside of the United States must be reported, and is subject to U.S. tax
  - Taxes on income earned by a corporation can be deferred until the corporation is repatriated to the United States

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# *Understanding International Taxation*

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Provisions to mitigate double taxation and under-taxation***
  - Foreign tax credit allows for offset of income taxes paid to a foreign country, up to the level that would be assessed under U.S. tax system
  - Foreign corporations with U.S. ownership can be taxed via "controlled foreign corporations" to reduce tax avoidance; the general deferral is excluded for tax haven operations

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# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit***
  - Amount of foreign taxes paid on foreign-sourced income can be applied against the amount of U.S. tax due
  - Cannot be used to reduce U.S.-sourced income
  - Subject to additional limitation (foreign tax credit limitation)
  - Taxpayer can choose to claim the credit or deduct foreign taxes paid or accrued

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit***
  - Allowed for income, war profits and excess profits taxes paid or accrued to a foreign country
  - Cannot be claimed against any U.S. tax that is not treated as a regular income tax
  - Credit is nonrefundable

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit***
  - Can also be claimed for indirectly-paid taxes
    - Domestic corporations that are shareholders in foreign corporations can claim the credit with respect to amounts attributable to foreign taxes paid on dividends, earnings and profits

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit – credit vs. deduction***
  - Generally better for taxpayer to credit rather than deduct
    - Credit reduces U.S. tax liability on a dollar-for-dollar basis; deduction just reduces the amount of income subject to U.S. tax
    - Credit can be claimed regardless of whether taxpayer itemizes deductions; deduction can only be claimed if itemized
    - Deduction cannot be taken for income that is exempt from U.S. taxes; same restriction does not apply to taxes credited

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### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit can be claimed by:***
  - U.S. citizens, whether residents or nonresidents;
  - Domestic corporations;
  - Alien residents of the United States; and
  - Alien individuals who are bona fide residents of Puerto Rico for the entire tax year.
- ***These taxpayers can also claim share of partnership or estate taxes***

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### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign tax credit for S corporations***
  - S Corp treated as a partnership; shareholders as partners
  - Foreign taxes paid by S corp will pass through to shareholders who can claim the foreign tax credit
  - S corp cannot claim credit with respect to foreign taxes paid by a foreign corporation in which it is a shareholder

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Which taxes can be considered in calculating foreign tax credit***
  - Creditable foreign taxes are generally based on net gain
  - IRS and Treasury regulations and rulings detail rules for addressing which foreign taxes are considered creditable
  - Foreign levy is creditable only if:
    - It is a tax
    - Its predominant character is that of an income tax in the sense of the U.S. tax system

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Is the levy a tax?***
  - Must require compulsory payment
  - Payment in exchange for economic benefit <u>is not</u> a tax
  - Dual capacity taxpayer (receives economic benefit in exchange for payment) must determine portion of payment that is a tax
    - Facts and circumstances method
    - Safe harbor method

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Is predominant character that of an income tax?***
  - Controlling factor is whether it would be considered to be an income tax under the U.S. tax system
    - Realization test
    - Gross receipts test
    - Net income test

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# *Understanding International Taxation*

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Numerous provisions address situations in which the foreign tax credit is limited or not allowed at all***
  - See examples on page 34-35

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## *Understanding International Taxation*

### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Payment of the foreign tax credit***
  - Person required to pay the tax is the individual on whom foreign law imposes legal liability
  - Special liability rules apply to partnerships and disregarded entities
  - Additional special rules may affect computation of credit for international business conducted by a partnership

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## *Understanding International Taxation*

### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Amount of creditable payment***
  - Credit cannot be applied to foreign tax amounts paid that fall under certain limitations
  - Amounts that can reasonably be expected to be refunded, credited, rebated, abated or forgiven are not included in the final estimated foreign tax liability
  - Taxes paid to a foreign country must be reported in U.S. dollars using exchange rate in effect when they were paid

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## *Understanding International Taxation*

### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Tax treaties***
  - Even if statutory and regulatory requirements are not met, foreign taxes may be creditable under terms of a tax treaty between two countries
  - Such claims should be reported on Form 8833
  - An additional credit for the portion of foreign tax imposed on U.S.-sourced income may also be available in some countries that have tax treaties with the United States



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### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Covered asset acquisitions***
  - Foreign tax credit is limited with respect to income or gain attributable to certain foreign assets in transactions as defined by regulations
  - The disqualified portion is determined as the ratio of allocable aggregate basis differences divided by income on which the foreign income tax is determined

# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Holding period***
  - Dividends from foreign stock: 16-day holding period (46-day in some cases) must be satisfied for credit to apply to taxes
  - Income producing property: property must be held for at least 15 days in a 31-day period; recipient can be under no obligation to make payments with respect to substantially-similar or related property





# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign earned income exclusion***
  - Allows U.S. citizen or resident to exclude a certain portion of foreign-sourced income from U.S. taxable income
  - Amount for 2016 is $101,300; adjusted annually for inflation
  - Includes an additional housing cost allowance exclusion

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# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Foreign earned income exclusion***
  - To claim, taxpayer must establish tax home in foreign country
    - Generally identified as principal place of business, or if not applicable, place of abode is controlling
    - To satisfy requirements, must qualify under *bona fide residence* or *physical presence* test

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# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Bona fide residence test***
  - Taxpayer must establish that he or she resided in foreign country for uninterrupted period of time that includes an entire tax year; if residence begins in the middle of a calendar year, taxpayer must wait until the end of the next complete year to satisfy the test
- ***Physical presence test***
  - Taxpayer must be physically present in a foreign country for at least 330 days during 12 consecutive months

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## Understanding International Taxation

### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Calculation of exclusion amount***
  - If exclusion is claimed (subject to limitations), foreign tax credit can be claimed for the amount not excluded
  - See example on pages 40-41

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### TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Year of the foreign tax credit***
  - Can be taken in the year taxes are accrued or when they were paid (depends on whether on accrual or cash basis)
  - Unused credits that cannot be claimed due to limitations for that year may be carried back two preceding years or carried forward to five succeeding years
  - Credit can be elected any time during 10-year period

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## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Claiming the foreign tax credit***
  - Most taxpayers compute and file for credit on Form 1116
  - Taxpayer with de minimis foreign tax credits may elect to be exempt from limitation rules; in this case, the credit is claimed directly on Form 1040; excess credit cannot be carried forward
  - Corporations use Form 1188 to calculate and file for the tax credit; affiliated group must compute on a consolidated basis

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# Understanding International Taxation

## TAXATION OF U.S. CITIZENS AND BUSINESSES

- ***Summary***
  - Determining eligibility and amounts of foreign tax credit can be very complex
  - However, taking the time to meet the requirements and do the calculations, can result in significant benefit for taxpayer
  - IRS Publication 514 excellent resource to answer questions about the foreign tax credit

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## Understanding International Taxation

SPECIAL RULES AND REPORTING

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## Understanding International Taxation

### SPECIAL RULES AND REPORTING

- ***FATCA requires "specified persons" to file information return with annual tax returns if foreign assets exceed threshold***
  - Specified individual: U.S. citizen, resident alien, nonresident alien who elects resident alien tax treatment or who is bona fide resident of Puerto Rico or a U.S. possession
  - Specified domestic entity: domestic corporation, partnership or trust formed or availed of to hold (directly or indirectly) specified foreign assets

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## *Understanding International Taxation*

### SPECIAL RULES AND REPORTING

- ***Foreign asset***
  - Generally, any stock or security issued by a person other than a U.S. person, or any other interest in a foreign entity that is held for investment
  - Assets held for use in the conduct of trade or business do not qualify



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## *Understanding International Taxation*

### SPECIAL RULES AND REPORTING

- ***Filing requirements***
  - Determined based on threshold amounts for different types of taxpayers (see chart on page 44)
  - Asset values should be determined and reported in U.S. dollars on Form 8938

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# *Understanding International Taxation*

## SPECIAL RULES AND REPORTING

- ***Foreign Bank and Financial Accounts Reporting (FBAR)***
  - One of five forms required by the Bank Secrecy Act
  - Required to be filed by U.S. financial institutions and all U.S. persons that have:
    - Financial interest in or signature authority over a bank account, securities or other financial account in a foreign country
    - Information must be reported annually on FinCEN 114

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# *Understanding International Taxation*

## SPECIAL RULES AND REPORTING

- ***Foreign Bank and Financial Accounts Reporting (FBAR)***
  - U.S. person: U.S. citizen, resident or entity formed under the laws of the U.S., its states, territories and possessions
  - Reportable account: bank account, security account or "other" financial account as defined by regulations, that is located in a foreign country (foreign bank branch in U.S. is not reportable)

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## *Understanding International Taxation*

### SPECIAL RULES AND REPORTING

- ***Foreign Bank and Financial Accounts Reporting (FBAR)***
  - Financial interest in or signature authority over:
    - Owner of record or holder of legal title
    - Constructive owner or deemed owner
    - Person who controls disposition of assets by direct communication with person with whom account is maintained
    - Many exceptions to the requirement

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## *Understanding International Taxation*

### SPECIAL RULES AND REPORTING

- ***Foreign Bank and Financial Accounts Reporting (FBAR)***
  - Reporting threshold – persons meeting all other requirements must file FinCEN Form 114 if aggregate value of accounts exceeds $10,000 at any time during the calendar year

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# *Understanding International Taxation*

## OVERVIEW OF INCOME TAX TREATIES



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# *Understanding International Taxation*

## OVERVIEW OF INCOME TAX TREATIES

- ***U.S. enters into treaties with other countries to alleviate issues of double taxation as well as to address various other topics***
  - Each treaty has unique identity and covers specific issues
  - Most treaties based on Model Income Tax Conventions
  - Treaties include operating rules to assist taxpayers and nations to comply with and enforce components (Competent Authorities)
  - Most-recent statutes and treaties will prevail

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# *Understanding International Taxation*

## OVERVIEW OF INCOME TAX TREATIES

- ***Residency determinations***
  - Must be determined to find out which rules apply
  - U.S. residents for purposes of model tax treaty are persons who are exposed to worldwide taxation
  - Taxpayers achieve residency status in only one jurisdiction
    - Determined by analysis of an individual's "permanent home," "center of vital interests," and "habitual abode"

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# *Understanding International Taxation*

## OVERVIEW OF INCOME TAX TREATIES

- ***Savings clause***
  - Provision in treaties that allows the United States to reserve the right to tax its citizens and residents as if there were no treaty in place
  - U.S. citizens and residents are afforded benefits by treaty:
    - Social security benefits only taxable by paying jurisdiction
    - Child support is never taxable

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# Understanding International Taxation

## OVERVIEW OF INCOME TAX TREATIES

- ***Compensation from personal services***
  - Broken into two separate classifications:
    - Independent personal services – services performed as an independent contractor
    - Dependent personal services – services performed as an employee or at the direction of another person



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Understanding International Taxation

## OVERVIEW OF INCOME TAX TREATIES

- ***Independent personal services***
  - Under U.S. model treaty, taxable only in the country of residence unless services are performed in the other treaty country and are attributable to a permanent establishment
  - Exemption only applies to income earned in country of source for the first 183 days

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# Understanding International Taxation

## OVERVIEW OF INCOME TAX TREATIES

- ***Dependent personal services***
  - Services are not taxable in country in which they were performed if:
    - Employee is present in country 183 days or fewer,
    - Compensation is paid by and employer who is not a resident of country of performance, and
    - Compensation is not borne by the employer's permanent establishment in the country of performance.

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# Understanding International Taxation

## OVERVIEW OF INCOME TAX TREATIES

- ***Special provisions for athletes and entertainers***
  - Travel too frequently for 183-day rule to apply, so clauses are added to prevent them from circumventing taxation
  - Generally sets an earnings threshold; if exceeded in one country, cannot claim treaty benefits under 183-day rule

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## Understanding International Taxation

### OVERVIEW OF INCOME TAX TREATIES

- ***Interest, dividends, royalties and gains***
  - Each treaty specifically addresses income from these sources
  - U.S. model treaty includes framework for withholding respect to these types of income from cross-border transactions
  - Specific treaty provisions should be consulted



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## Understanding International Taxation

### CONCLUSION AND PRACTICAL CONSIDERATIONS

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# Understanding International Taxation

## CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***International tax***
  - Complexity makes planning a critical element for maintaining competitive worldwide status

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# Understanding International Taxation

## CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***International tax***
  - OECD members
    - Cross-border tax systems have not kept pace with how business is conducted in the global economy

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## Understanding International Taxation

### CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***International tax***
  - Base erosion and profit shifting (BEPS)
    - To combat BEPS, OECD set a plan in 2013

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## Understanding International Taxation

### CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***International tax***
  - Six areas of focus in OECD Plan for BEPS:
    - Address concerns with respect to the digital economy
    - Establish international coherence of corporate income taxation
    - Restore the full effects and benefits of international standards
    - Assure that transfer pricing outcomes are in line with value creation
    - Ensure transparency while promoting increased certainty and predictability
    - Address the need for swift implementation

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## *Understanding International Taxation*

### CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***International tax***
  - Taxpayers, both individuals and corporations, must focus on laws and treaties as they currently exist





## *Understanding International Taxation*

# THANK YOU!