Potential Tax Deferral and Mitigation Structuring

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2014

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U.S. Tax Overview

- U.S. Citizens and Residents (including U.S. corporations) are taxed on their worldwide income. The long-term capital gain tax rate is 20% (if income over $450,000) and the current maximum income tax rate for ordinary income is 39.6%.
- An additional 3.8% tax will be applied on investment income. The 3.8% tax will apply on individuals with Adjusted Gross Income ("AGI") above $200,000.00 and couples with AGI over $250,000.00.
- Investment income includes dividends, interest, rents and capital gains.
- Typically, dividends received from U.S. corporations and non-U.S. corporations are taxed at ordinary income tax rates (39.6% tax).
- Shareholders of U.S. corporations may be entitled to a "qualified dividend" rate at the current long-term capital gain tax rate of 20%, so long as certain requirements are met.
- Either way, dividends received from U.S. corporations are taxed in the income tax year that they are received by the taxpayer.

Deferral of Income

- U.S. income tax is recognized in the tax year in which the income is earned unless there is an opportunity to defer such income tax.
- Using corporations outside of U.S. may allow for a deferral of the U.S. income tax until such time the income generated is distributed (whether actually or constructively) back to the U.S. beneficial owner.
- In order to structure a business outside of the U.S., it must be the right business model and comply with numerous U.S. rules and regulations.

Qualified Foreign Corporation

- In 2003, the U.S. enacted an Act that allowed for dividends paid to individual shareholders from either a domestic corporation or a "qualified foreign corporation" to be subject to tax at a reduced rate applicable to long-term capital gain tax rate (currently 20%).
- A Qualified Foreign Corporation ("QFC") is a corporation that is organized in a country that is eligible for the benefits of a comprehensive income tax treaty with the U.S. The IRS has issued notices, which include a list of the countries in which a corporation situated therein would qualify as a QFC.
- Public companies ("C" corporations) cannot take advantage of this planning.
- Essentially, the dividends received from a QFC will be taxed at long-term capital gain tax rate (20%) instead of the typical income tax at ordinary income rates (39.6%). A savings of almost 20% per income tax year.

Intellectual Property Royalty Payments

- It may be possible to migrate intellectual property ("IP") outside the U.S. or create additional IP income outside the U.S. that can take advantage of deferral opportunities and potential mitigation through the appropriate structuring.
- Typically, when royalty payments generated from the licensing of IP are received by a company beneficially owned by U.S. citizens or residents (either directly or indirectly), that income is recognized as passive income known as Subpart F Income. Subpart F Income must be recognized in the tax year in which the income is generated. However, due to specific rules and regulations, there are exceptions which will shift the classification of the royalty payment to active income.
- In order to ensure that the exception is met, there are requirements with respect to the IP income which must be maintained.

Foreign Tax Credit

- The U.S. allows for a credit against U.S. income taxes paid in a foreign jurisdiction in certain situations.
- Certain offshore planning techniques allow for the foreign tax credit for the foreign taxes paid.
- When the credit is recognized, the foreign tax will be applied against the overall U.S. income tax due for such transactions. Meaning, the U.S. taxpayer will owe the difference between the overall U.S. income tax due and what was paid in tax in the foreign jurisdiction.

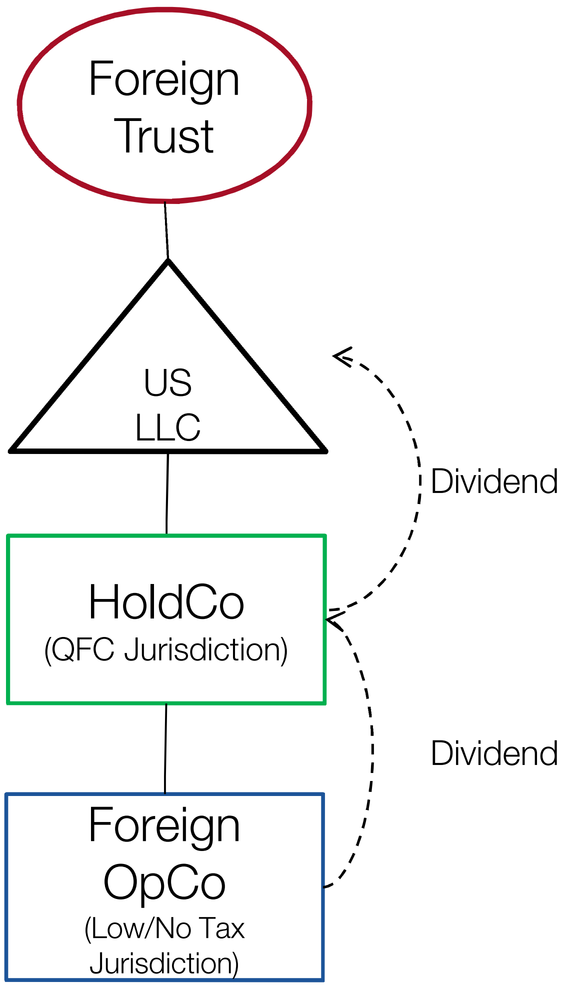
Deferral and Mitigation Structure Explained

- Under this structure, the U.S. taxpayer will own 100% of the interest of a foreign entity located in a QFC jurisdiction ("HOLDCO") with an income tax regime that does not tax income from subsidiaries (a Participation Exemption). Additionally, the jurisdiction should be one that allows for the subsidiary companies to be established in jurisdictions with low or zero income tax.
- HOLDCO will own 100% of the interest of a foreign entity located in a country that does not have an income tax or a low income tax and with a qualified treaty with the U.S., in order to own and operate the IP and to eliminate the withholding tax on royalty payments from inside the U.S. for the IP ("IpCo").
- HOLDCO will also own 100% of the interest of a foreign entity located in a country that does not have an income tax or a low income tax which will operate the business throughout the world ("OpCo").

Deferral and Mitigation Structure Results

- OpCo will be able to generate income from the operation of the business without incurring any income tax at the OpCo level.
- IpCo will be able to generate income from license of IP without incurring any income tax at the IpCo level.
- OpCo and IpCo will be able to make distributions to HOLDCO without incurring any withholding tax.
- Income earned by IpCo and OpCo will be able to be Deferred in HOLDCO without any application to U.S. income tax until a distribution is made to the U.S. taxpayer (whether actively or constructively) when such distributions are made, the U.S. income tax will be 20%.
- The funds that are deferred can be invested in an investment account.
- By using HOLDCO, any future expansion with respect to international business will not have to be co-mingled in either OpCo or IpCo as HOLDCO allows the flexibility to establish new subsidiaries and all future investments outside the U.S. will be pre-U.S. income tax.

Sample Deferral Structure



- Foreign Trust offers asset protection and succession planning
- Income earned by OpCo is not taxed in these jurisdictions
- Income can be deferred in HoldCo without any US income tax until the dividends are repatriated to the US
- Using qualified jurisdictions, the dividend paid to the US LLC, and ultimately the Trust, is taxed at 20% instead of 39.6%

Puerto Rico Tax Incentive - Act 20

Act 20-2012 – Export Services

- Benefits provided under a 20 year decree:

  ✓ 4% income tax rate

  ✓ 100% exempt distributions

  ✓ 60% exemption from municipal license taxes (90% if located in development zones of Vieques or Culebra)

  ✓ 90% exemption from Real and Personal Property taxes

- (ii) for foreign markets or promotion services.

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  ✓ Research and Development
  ✓ Advertising and Public Relations
  ✓ Economic, environmental, technological, scientific, managerial, marketing, human resources, information systems, engineering, auditing and consulting services
  ✓ Consulting services for any trade or business
  ✓ Commercial art and graphic services

Puerto Rico Tax Incentive - Act 20

Act 20-2012 – Export Services

- “Eligible services:”

  - ✓ Production of engineering and architectural plans and designs, and related services
  - ✓ Professional services as legal, tax and accounting services
  - ✓ Centralized managerial services, including, but not limited to, strategic direction, planning and budgeting, that are performed by a headquarters company or a regional headquarters that is engaged in the business of providing such services
  - ✓ Services performed by electronic data processing centers
  - ✓ Development of licensable computer software
  - ✓ Telecommunications voice and data between persons located outside of Puerto Rico
  - ✓ Call Centers
  - ✓ Shared service centers
  - ✓ Medical and hospital services, including reference laboratories services
  - ✓ Investment banking and other financial services, including but not limited to asset management, management of investment alternatives, management of activities related to private capital investment, management of coverage funds or high risk funds, management of pools of capital, trust management that serves to convert different groups of assets into securities, and escrow accounts management services

Puerto Rico Tax Incentive - Act 20

Act 20-2012 – Export Services

- The Eligible Services provided must not be related to the conduct of a trade, business or other activity in Puerto Rico.

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  - ✓ Export Services related to the establishment of a new business in Puerto Rico and that are designated as eligible services, regardless of its nexus with Puerto Rico. Generally, benefits are limited with respect to a particular service once the target customer establishes its business in Puerto Rico.

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Puerto Rico Tax Incentive - Act 22

Act 22-2012 – Resident Individual Investors

Background – U.S. Taxation in Puerto Rico – Individuals

- Bona fide residents of Puerto Rico (U.S. citizens or not) are subject to U.S. federal income taxes o a worldwide basis, pursuant to the Regs. 1.1-1(b).

- Section 933 of U.S. Code, however, excludes from U.S. income taxation all income derived from Puerto Rico sources by a "bona fide" resident of Puerto Rico.

- A bona fide resident of Puerto Rico is one that meets the physical presence, tax home and closer connection tests prescribed in the Regs. 1.937-1.

- Generally the relevant sourcing rules are:

  ✓
  ✓
  ✓
  ✓
  ✓

Puerto Rico Tax Incentive - Act 22

Act 22-2012 – Resident Individual Investors

Background – U.S. Taxation in Puerto Rico -- Individuals

- Individuals who acquire their United States citizenship solely by reason of their birth or residence in Puerto Rico and who are residents of Puerto Rico at the time of death (defined herein as PR Citizens) will be considered "Nonresidents not Citizens of the United States" for purposes of the estate tax imposed by the Federal Code. See, Section 2209 of the Federal Code.

- The estate of such "Nonresident not citizen of the United States" will be taxed only on the part of the estate located in Puerto Rico.

- Income Taxes – maximum rate 33%

- Alternative Minimum Tax – 20%

- Sales and Use Tax – 7%

- Property Taxes:

  ✓ Real Property taxes vary by municipality- approximately 10% based on 1954 values.

- Estate and Gift Taxes – 10% and tax credit for estate taxes paid to U.S.

Puerto Rico Tax Incentive - Act 22

Act 22-2012 – Resident Individual Investors

- Eligibility – Individual Resident Investor
  - ✓ An Individual Resident Investor is an individual who has not been a resident of Puerto Rico for the past 15 years before his first years of residence in Puerto Rico.
- Benefits
  - ✓ 100% income tax exemption (including alternative minimum tax) on interest and dividends received.
  - ✓ 100% exemption for capital gain accrued after becoming a resident of PR and realized before January 1, 2036.
  - ✓ 10% tax on capital gain accrued before PR residency and realized within 10 years of becoming a PR resident (5% after 10 years, but before January 1, 2036 on gain accrued before becoming a PR resident.
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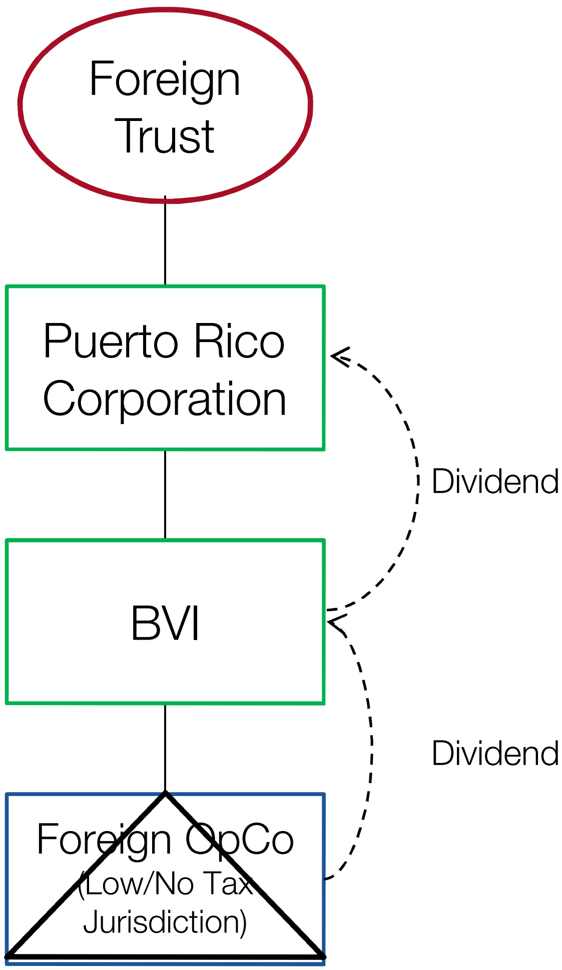
Puerto Rico Deferral Structure



- Foreign Trust offers asset protection and succession planning
- Income earned by OpCo is not taxed in these jurisdictions
- Dividends received by the Foreign Trust are taxed at 20%
- Under the Tax Incentives of Act 20, the Puerto Rico corporation would pay 4% corporate tax, instead of 20%+ on all Puerto Rico source income.
- Global rate: 23.2%

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