<u>Pautas Fiscales Cuando Te Asocias con el Tío Sam - Extranjeros Haciendo Negocios en los EE.UU.</u>

Por: José Luis Nuñez, Esq.
Packman Neuwahl & Rosenberg
1500 San Remo Ave. Suite 125
Coral Gables, Florida 33146
Telephone: (305) 665-3311
Fax: (305) 665-1244

The following outline provides a very general discussion of a number of the different planning alternatives for a foreign investor's ownership of a USRPI or other U.S. business asset. Please note that this outline is intended to review <u>only</u> those circumstances where the structure in question is the <u>original acquirer</u> of such an interest, as numerous complex rules (a discussion of which is outside the scope of this outline) apply to <u>transfers</u> of existing interests to one or more of these structures.

Each different type of investment and business structure has its own advantages and disadvantages. Planning opportunities may be different based upon the age and health of the person(s) in question.

THIS OUTLINE IS NOT INTENDED AS A COMPLETE ANALYSIS OF ALL POSSIBLE TAX CONSIDERATIONS IN ACQUIRING, HOLDING AND DISPOSING A MEMBERSHIP INTEREST IN A FLORIDA LLC OWNING ONE OR MORE USRPIs. EACH INVESTOR IS RESPONSIBLE FOR HIS, HER, OR ITS OWN TAX PLANNING DECISIONS, PARTICULARLY SINCE THE POTENTIAL RELATED FEDERAL, STATE, LOCAL AND POSSIBLY THIRD COUNTRY TAX ISSUES AND CONSEQUENCES MAY NOT BE THE SAME FOR ALL INVESTORS. INVESTORS SHOULD THEREFORE CONSULT THEIR OWN U.S. AND THIRD COUNTRY TAX ADVISORS FOR SPECIFIC GUIDANCE REGARDING THE MATTERS DISCUSSED HEREIN.

LEGEND OF SELECTED ABBREVIATIONS

BLIT—the U.S. branch level interest tax (see, e.g. IRC § 884). In circumstances where a borrower is a foreign corporation engaged in a USTB, which status can result through, for instance, an LLC which has a USRPI-related trade or business or gains treated as such, the interest paid may be subject to the U.S. 30% flat tax subject to certain exemptions (for example, the PIE) and/or U.S. income tax treaty benefits.

BPT—the U.S. branch profits tax (see, e.g. IRC § 884). If a foreign corporation does not reinvest its annual U.S. trade of business earnings and profits (i.e., its effectively connected earnings and profits) in accordance with certain specific IRS regulations, those earnings and profits not so reinvested will be treated as if they had been distributed as a dividend to the foreign corporation's shareholders, and subject to a 30% flat tax with payment responsibility placed on the foreign corporation.

ECI—effectively-connected income, generally income derived from a USTB, or income from the sale of a USRPI which is treated as ECI

E&P—earnings and profits

ECE&P—effectively-connected earnings and profits (for BPT purposes)

FC—foreign (non-U.S.) corporation. The corporation could be established in any non-U.S. jurisdiction, with the most desirable place of formation to be determined in part depending upon each person's individual situation.

FIRPTA—Foreign Investment in Real Property Tax Act of 1980, as amended (see, e.g., 897 and 1445). This complex law and the Treasury Regulations interpreting these statutes have governed the U.S. income tax law relating to transfers of USRPIs since it became law.

IRC—Internal Revenue Code of 1986, as amended (the U.S. tax law)

IRS—Internal Revenue Service (the federal tax authority)

LLC—limited liability company (a type of legal entity that, among other uses, is commonly formed to hold USRPIs—depending upon various factors, it can be treated as either a pass-through entity or as a corporation for U.S. tax purposes.

NOL—net operating loss

NRA—nonresident alien individual for U.S. income tax purposes

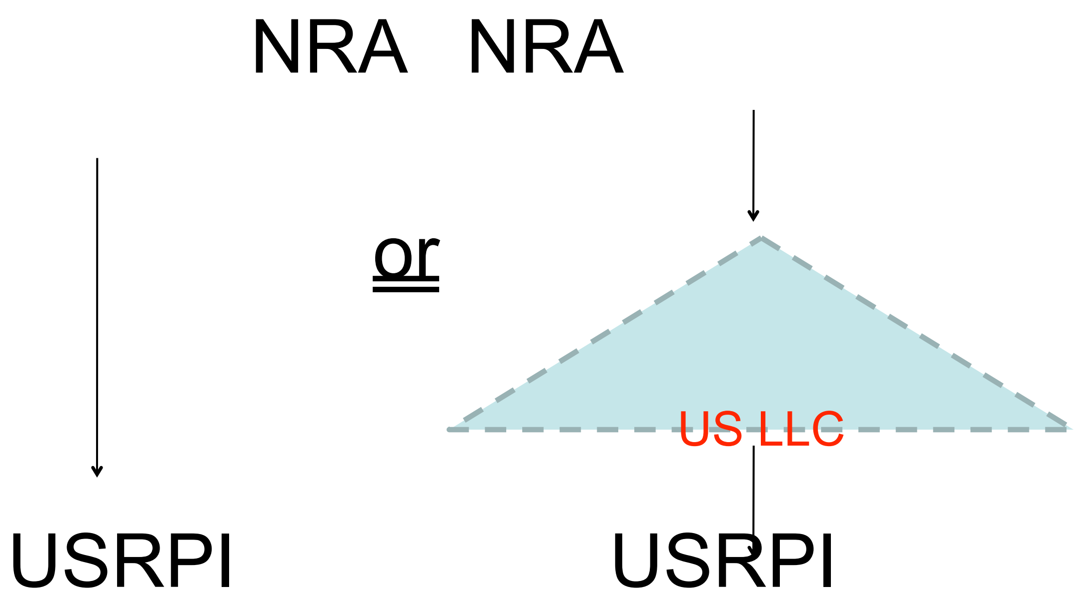
PIE—portfolio interest exemption, which enables interest to be paid free of U.S. tax to a foreign lender under certain circumstances

USCO—domestic (for example, Florida) corporation

USRPI—United States real property interest (throughout this outline, it is presumed that the Florida LLC in which each foreign investor may invest holds only USRPIs and that an interest in the Florida LLC is itself a USRPI)

USTB—United States trade or business

Alternative 1—NRA Directly Owns the USRPI or through a Single Member LLC Disregarded for U.S. tax purposes



Alternative 1—NRA Directly Owns the USRPI or through a Single Member LLC Disregarded for U.S. tax purposes

Advantages:

1. This structure potentially results in the lowest overall U.S. income tax rate with respect to income earned from a taxable disposition of the USRPI (currently 15% capital gains if the USRPI is held more than one year; otherwise 35% maximum ordinary income). In addition, there is only one level of U.S. income tax imposed upon NRA.
2. This is the least complex and cheapest structure to form and maintain.
3. No BPT or BLIT.

Alternative 1—NRA Directly Owns the USRPI or through a Single Member LLC Disregarded for U.S. tax purposes

Disadvantages:

1. No anonymity potential except that if LLC is used, LLC would appear as the owner of the USRPI under the real estate public records—note, however, that planning should never be solely based upon a desire for anonymity, as it cannot be guaranteed, particularly where there is a tax treaty between the U.S. and the country of the investor's residence or because of existing banking and money regulations.
2. The filing of an NRA individual U.S. income tax return (Form 1040NR) upon disposition or sooner if the

Alternative 1—NRA Directly Owns the USRPI or through a Single Member LLC Disregarded for U.S. tax purposes

USRPI is a USTB property or a "net election" is made to treat it as a USTB property.

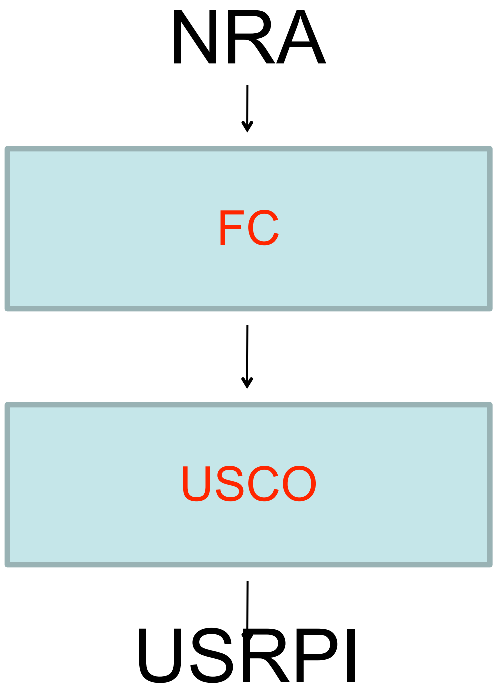
3. FIRPTA withholding applies to the NRA's sale of the USRPI (generally, 10% of purchase price, credited against actual tax due). If the foreign seller knows that the seller's U.S. income tax liability will be less than the gross 10% withholding tax, the seller can utilize certain procedures to request the reduction of the withholding tax.
4. No U.S. estate and gift tax protection.

Alternative 1—NRA Directly Owns the USRPI or through a Single Member LLC Disregarded for U.S. tax purposes

Planning Notes:

1. As a hedge against the U.S. estate tax, consider obtaining U.S. life insurance, which is a foreign situs asset exempt from U.S. estate tax where the insured is a nonresident alien decedent.
2. Check applicable U.S. tax treaties.
3. Can pay out U.S. tax-free foreign source interest on U.S. business related debt and obtain deduction where business assets secure such debt or where debt is "booked" to a U.S. trade or business, subject to a percentage limitation.

Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI



Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI

Advantages:

1. A 34/35% U.S. income tax rate applies, plus applicable state (for example, Florida) income tax, but only one level of U.S. income tax is imposed if USCO makes only a single liquidation distribution without paying dividends. It must be remembered, however, that to the extent USCO has annual E&P, the income resulting from retaining such E&P will result in additional annual gross income potentially subject to U.S. corporate income tax, subject to exceptions for certain tax-exempt investments.
2. No U.S. estate or gift tax.

Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI

3. Limited legal liability at the FC and USCO levels.
4. Extra level of potential anonymity.
5. No BPT or BLIT.
6. No FIRPTA withholding would apply to the sale of USCO’s USRPI because FIRPTA withholding does not apply to the disposition of a USRPI owned by a U.S. person. If FC sold or liquidated USCO, FIRPTA withholding would apply if USCO has not disposed of all of its USRPIs in taxable transactions, subject to FC’s possibly having such withholding reduced as mentioned in Alternative 1.

Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI

Disadvantages:

1. U.S. income tax rate may be greater than individual rate.
2. A relatively expensive structure to create and maintain.
3. Interest-stripping limitation and the related foreign person guarantee rule. If FC or a party related to FC makes loans to USCO, and the interest USCO pays is otherwise exempt from or subject to a reduced rate or withholding under the PIE and/or a tax treaty, USCO may find its interest deduction limited if its debt to equity ratio exceeds 1.5 to 1.

Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI

4. A 30% U.S. withholding tax applies to dividends paid by from USCO to FC unless a U.S. tax treaty provides a lower rate.

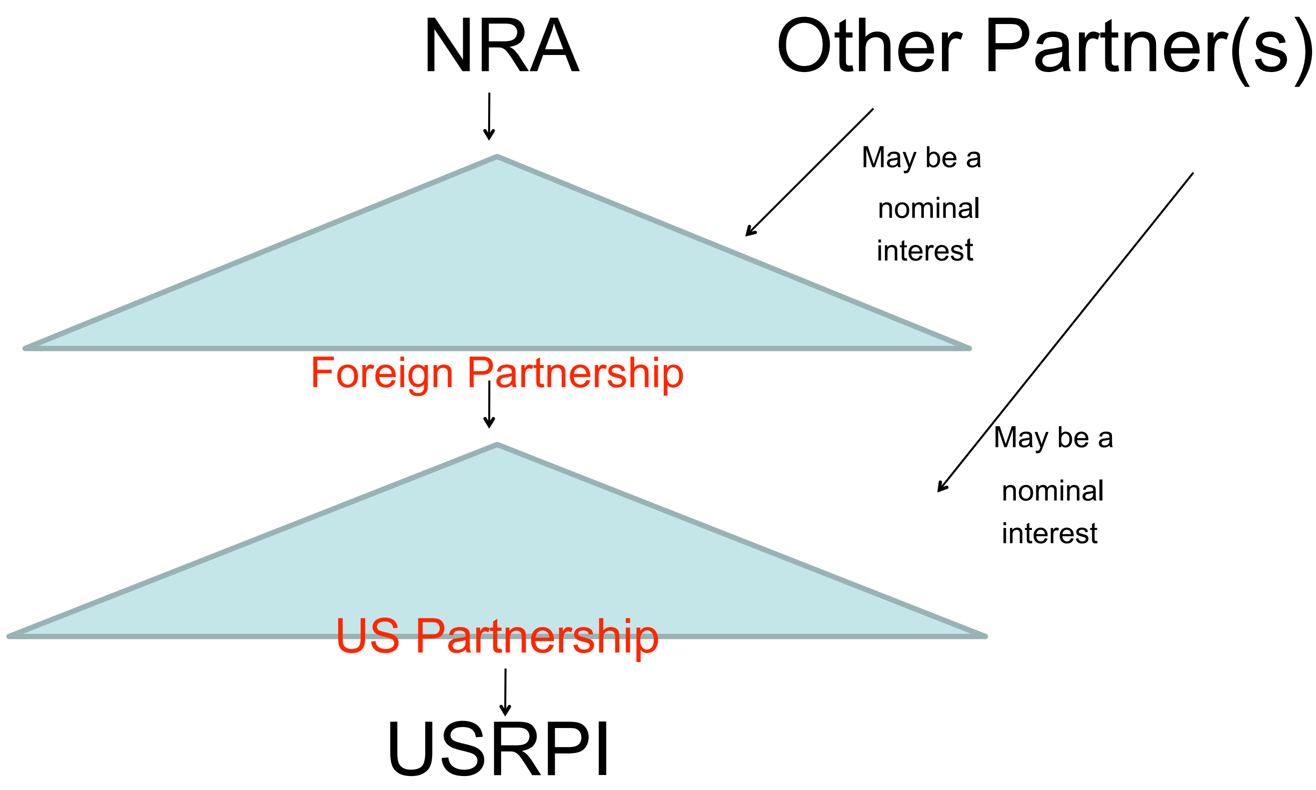
Planning Notes:

1. When funding USCO consider the implications of equity versus debt as interest paid on a loan from USCO to FC could result in a less expensive alternative for returning capital plus some earning to FC.

Alternative 2—NRA Owns FC Which Owns USCO Which Owns the USRPI

2. Other alternatives include structuring a loan from NRA or FC to qualify for the PIE or for reduced taxation under an applicable U.S. tax treaty.
3. Need to consider the effect of holding multiple USRPIs in one DC versus holding one USRPI per DC and possible effect of tax consolidation. Difficult to avoid second level tax if USCO cannot liquidate.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI



Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

Advantages:

1. This structure also potentially results in the lowest overall U.S. income tax rate with respect to income earned from a taxable disposition of the USRPI (currently 15% capital gains if the USRPI is held more than one year; otherwise 35% maximum ordinary income). In addition, there is only one level of U.S. income tax imposed upon NRA or other income, as the partnership is a “pass-through” entity for U.S. income tax purposes.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

2. If partnership is a limited liability company or a limited partnership where NRA is a limited partner, limited legal liability.
3. No BPT or BLIT considerations.
4. Arguably, no U.S. gift tax would be imposed upon a transfer of a partnership interest, but unclear, and maybe the same result regardless of whether the gift is of a U.S. or foreign partnership.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

Disadvantages:

1. USTB or permanent establishment of partnership causes such status (and U.S. income tax return filing requirements) at NRA partner level.
2. No real anonymity.
3. No limited legal liability if NRA is a general partner in a limited partner except per a specific state law.
4. Potential U.S. estate tax, as the applicable law is not entirely clear, especially if the USRPI is treated as a USTB, although arguments to the contrary exist.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

5. Subject to special U.S. withholding tax rules for partnerships with foreign partners with regard to taxable ECI of any foreign partner but the regulations allow for a reduction based on a foreign partner's deductions and losses reasonably expected to be available.
6. Possibly U.S. gift tax upon a transfer by NRA of a partnership interest although potential arguments to the contrary exist.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

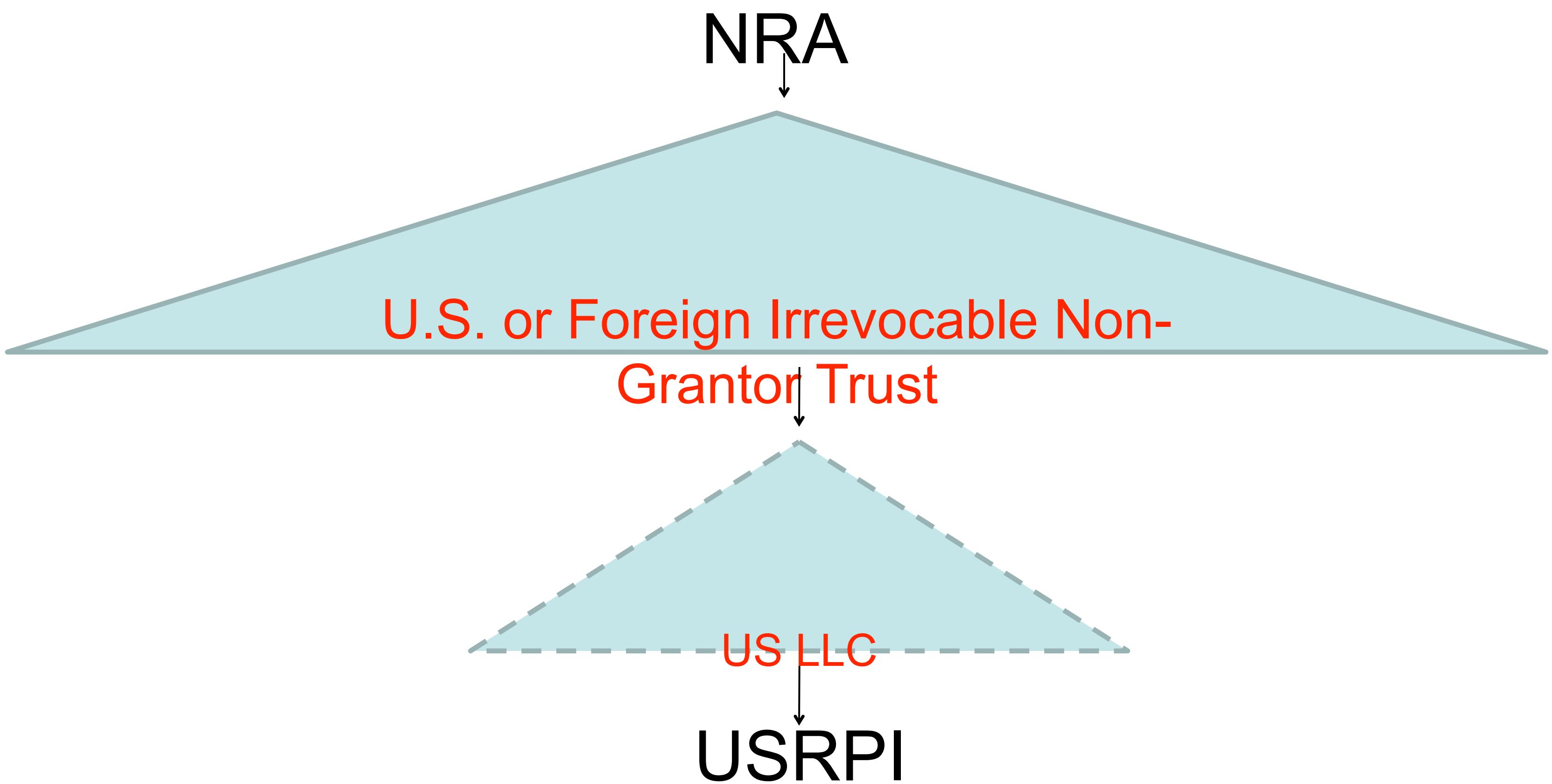
Planning Notes:

1. Strong differences of opinion exist among tax practitioners regarding whether this structure in fact provides potential U.S. estate tax protection.
2. Consider PIE planning with respect to loans to be made to the partnership but be careful with certain rules limiting interest deduction or allocation in the case of a foreign partner.

Alternative 3—NRA is a Partner in a Foreign Partnership Which Owns a U.S. Partnership which Owns the USRPI

3. Consider alternatives to reduce equity value of the partnership via funding through loans for U.S. estate tax purposes.
4. Be certain that partnerships take the form of eligible entities which may elect to become a corporation if desired and be alert of timing issues related thereto.

Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)



Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)

Advantages:

1. This structure also potentially results in the lowest overall U.S. income tax rate with respect to income earned from a taxable disposition of the USRPI (currently 15% capital gains if the USRPI is held more than one year; otherwise 35% maximum ordinary income) or other income. In addition, there is only one level of U.S. income tax imposed (upon either the trust or possibly a beneficiary, depending upon the terms of the trust).

Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)

2. No BPT or BLIT considerations.

Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)

Disadvantages:

1. USTB status or permanent establishment of trust creates such status at trust or beneficiary level, depending upon the trust's terms. This could result in beneficiary having a US tax filing obligation.
2. No real anonymity.
3. No limited liability for the trust, but potential liability protection for the trust's beneficiaries depending upon the trust's terms.

Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)

Planning Notes:

1. This structure can have excellent overall U.S. tax-related benefits. However, for maximum potential benefits, the investor must truly be willing to give up control over the trust assets.
2. If a foreign trust, possible planning for U.S. income tax free payments of certain foreign source interest but be careful with certain rules limiting interest deduction or allocation in the case of a foreign partner.

Alternative 4—NRA Establishes U.S. or Foreign Non-Grantor Irrevocable Trust Which Owns the USRPI (NRA Retains No Tainted Rights, Powers, Benefits, Interest in or Control Over the Irrevocable Trust)

3. If a U.S. trust possible planning for U.S. income tax free payments of PIE interest.