Introduction to International Tax

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Overview of U.S. Income Taxation

- U.S. persons—e.g., citizens, residents, and domestic corporations—are generally subject to U.S. income taxation on their worldwide income regardless of the source.
- Foreign persons—e.g., a nonresident alien or foreign corporation—are generally subject to U.S. taxation on:
  - U.S.-source "FDAP"
  - Income that is effectively connected with the conduct of a U.S. trade or business
  - FIRPTA

Question 1

Billy, are you here?

Income Tax Residents

- Objective Test
  - U.S. Citizens
  - Legal Permanent Resident (a.k.a. the "Green Card" Test)
  - Substantial Presence Test
  - First-year election
- Exceptions to the Substantial Presence Test
  - Certain exempt individuals, including students, teachers, athletes, & government employees
  - Individuals with medical conditions
  - Demonstrate a "Closer Connection " to another country (Form 8840)
  - Treaty-based exception (Form 8833)

Substantial Presence Test

	Days Present in the United States	Fraction Counted	Days Counted
Non-Resident for 2015			
2013	120	1/6	20
2014	120	1/3	40
2015	120	1	120
		Total	180
Resident for 2015			
2013	120	1/6	20
2014	150	1/3	50
2015	120	1	120
		Total	190

Substantial Presence Test

	Days Present in the United States	Fraction Counted	Days Counted
Medical Exception—Non-Resident for 2015			
2013	120	1/6	20
2014	150, but 30 for medical reasons	1/3	40
2015	120	1	120
		Total	180
All on student visa—Non-Resident for 2015			
2013	180	1/6	0
2014	180	1/3	0
2015	180	1	0
		Total	0

Income Taxation of Nonresident Aliens

- Dual-Status Year Returns
  - No standard deduction, but may claim exemptions for spouse and dependents while a resident.
  - May not file a joint return or file as Head of Household.
  - If you end the year as a resident alien, file Form 1040 with a statement showing income from nonresident portion of the year.
  - If you end the year as nonresident alien, file Form 1040NR with a statement showing income from resident portion of the year.

Question 2

Billy is here as a resident alien under the Substantial Presence Test, but his wife isn't.

If she's not here, what does that mean?

Income Taxation of Nonresident Aliens

- Effectively Connected Income ("ECI")
  - Net-basis taxation for business income
- Gains from the Sale of Real Property—FIRPTA
  - Subject to mandatory 15% withholding, and taxed as ECI
  - Certain taxpayers are subject to 10% withholding
- Fixed, Determinable, Annual, or Periodical Income ("FDAP")
  - All income other than gains from sale of property or income excluded from gross income
    - Dividends
    - Interest
    - Pensions and annuities
    - Alimony
    - Rent and Royalties
  - Gross-basis taxation subject to mandatory 30% withholding
- Gains from the Sale of Non-Real Property—Not Taxed

Income Taxation of Nonresident Aliens

- Billy is a resident alien, but his wife is a non-resident alien.
  - They may elect to have the spouse treated for U.S. income tax purposes as a resident alien.
  - They must file a joint tax return for the first year of the election, but may file separate returns in later years.
  - If they elect to treat the spouse as a resident alien, neither of them may claim to be treated as a non-resident under any tax treaty.

Question 3

If Billy's here, how can he mitigate his U.S. income tax burden?

Mitigating US Income Tax

- Foreign Tax Credit—Form 1116 and Form 1118
  - A credit or an itemized deduction is allowed for taxes paid to a foreign country or U.S. possession if the same income is also subject to U.S. tax.
- Foreign Earned Income Exclusion
  - Up to $107,600 of foreign earned income in 2020
  - Or foreign earned income less foreign housing exclusion
  - Requirements
    - Qualified Individual—either a citizen or resident alien
    - Have foreign earned income
    - Meet the Bona Fide Residence Test or the Physical Presence Test
    - “Tax Home” in a foreign country
    - Valid Election on Form 2555 or Form 2555-EZ

Foreign Tax Credit

Foreign Income	Foreign Tax Rate	Foreign Tax	US Tax (40% rate)	US Foreign Tax Credit	Total Tax (F + US)
$100	0%	0	$40	0	$40
$100	15%	$15	$25	$15	$40
$100	25%	$25	$15	$25	$40
$100	35%	$35	$5	$35	$40
$100	45%	$45	0	$40	$45

Foreign Earned Income Exclusion

Income Type ($100 of each)	Foreign Tax Rate	Foreign Tax	US Tax Rate	US Tax
Foreign Earned Income	10%	$10	0*	$0 ($0 credit)
US Earned Income	0%	0	40%*	$40*
Dividends (US)	0%	0	20%	$20
Dividends (F)	10%	$10	20%	$10 ($10 credit)
Interest (US)	0%	0	40%	$40
Interest (F)	5%	$5	40%	$35 ($5 credit)

* Wages are subject to U.S. Social Security and Medicare taxes

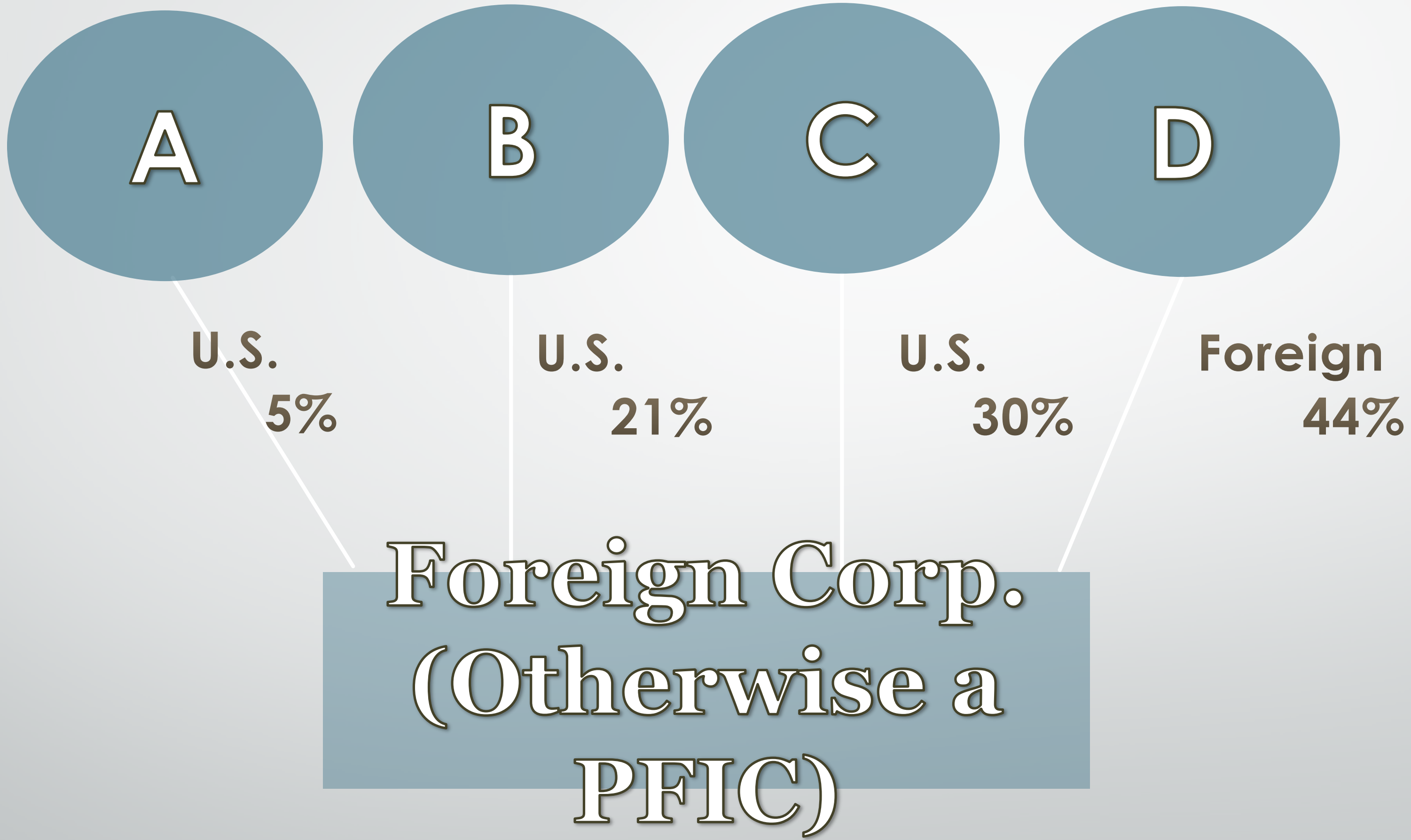
Controlled Foreign Corporation ("CFC")

- A foreign corporation that has "U.S. shareholders" that own (directly, indirectly, or constructively), more than 50% of:
  - The total combined voting power of all classes of voting stock; or
  - The total value of the stock.

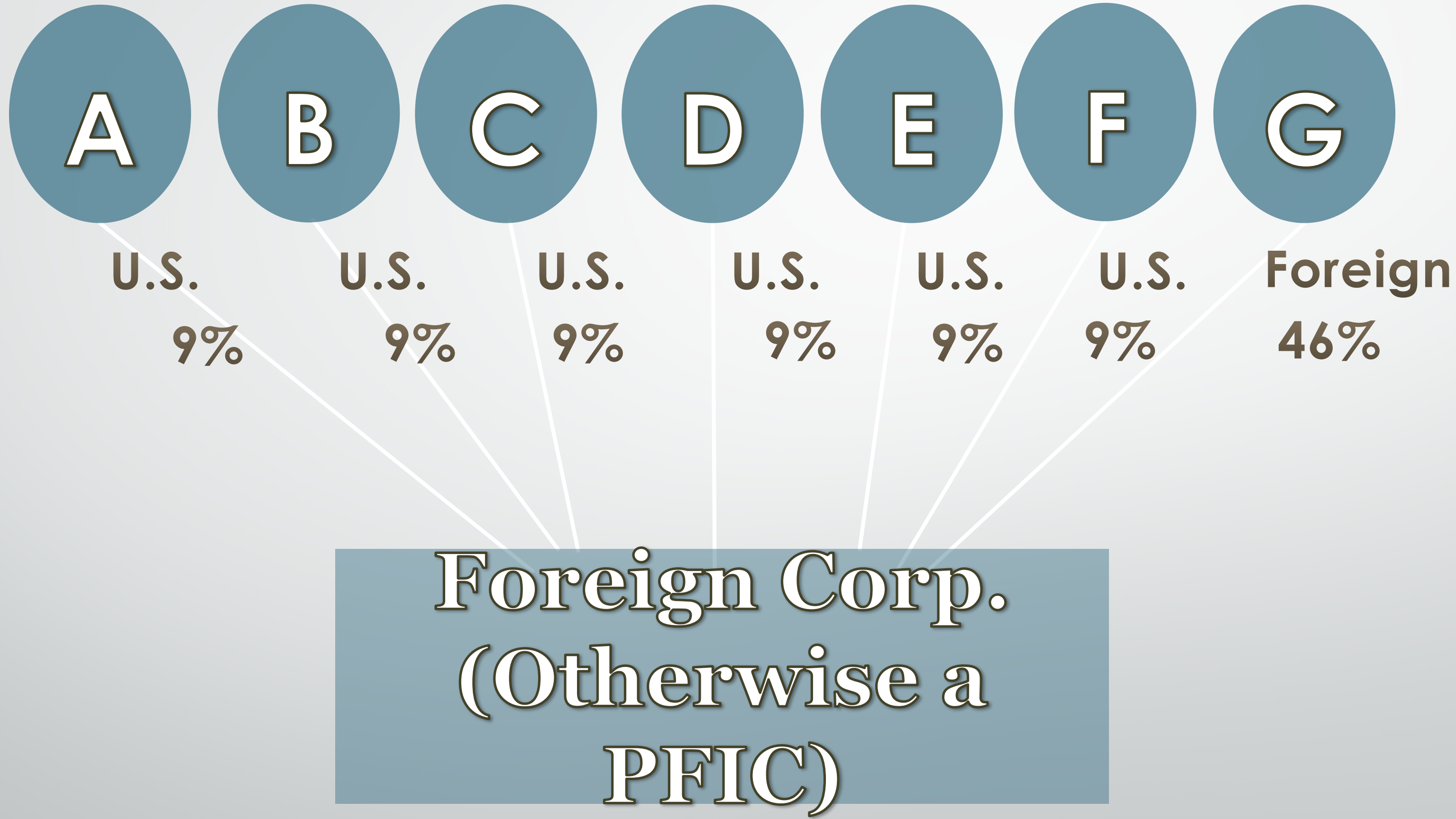
Controlled Foreign Corporation ("CFC")

- A "U.S. shareholder" is, generally, a U.S. person who:
  - Owns (directly, indirectly, or constructively) 10% or more of the total combined voting power or value of all classes of voting stock of a CFC.

Controlled Foreign Corporation ("CFC")



Controlled Foreign Corporation ("CFC")



Subpart F Income

- Three key categories of Subpart F income:
  - Foreign Base Company Sales Income
  - Foreign Base Company Services Income
  - Foreign Personal Holding Company Income

PFIC's Defined

- PFIC Tests:
  - Passive Income Test
  - 75% or more of GI is passive income
  - Passive Asset Test
    - 50% or more of assets produce, or are held for production of, passive income

PFIC Tax Regimes

- PFIC Tax Regimes:
  - Excess Distribution (aka "1291 fund")
  - Qualified Electing Fund ("QEF")
  - Mark-to-Market

Question 4

Billy, where are you from?

U.S. Income Tax Treaty System

- The U.S.A. is a party to 59 bilateral income tax treaties with 66 countries.
  - The U.S.-U.S.S.R income tax treaty applies to Armenia, Azerbaijan, Belarus, Georgia, Krgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.
  - The U.S.-China income tax treaty does not apply to Hong Kong.
- Four protocols (Japan, Luxembourg, Spain, & Switzerland) were approved by the Senate in 2019.
- Four treaties have been signed but not approved by the Senate.
  - Chile signed in 2010 (first treaty)
  - Hungary signed in 2010 replacing 1979 treaty
  - Poland signed in 2013 replacing the 1974 treaty
  - Vietnam signed in 2015 (first treaty)

U.S. Income Tax Treaties

IRS

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- Corporations
- Partnerships
- International Businesses
- Small Businesses & Self-Employed

International Businesses Topics

- Individual Taxpayer
- Income Tax Treaties
- KYC Rules
- **International Businesses Home**

United States Income Tax Treaties - A to Z

The United States has tax treaties with a number of foreign countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from U.S. taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income. Under these same treaties, residents or citizens of the United States are taxed at a reduced rate, or are exempt from foreign taxes, on certain items of income they receive from sources within foreign countries. Most income tax treaties contain what is known as a "saving clause" which prevents a citizen or resident of the United States from using the provisions of a tax treaty in order to avoid taxation of U.S. source income.

If the treaty does not cover a particular kind of income, or if there is no treaty between your country and the United States, you must pay tax on the income in the same way and at the same rates shown in the instructions for the applicable U.S. tax return.

Many of the individual states of the United States tax income which is sourced in their states. Therefore, you should consult the tax authorities of the state from which you derive income to find out whether any state tax applies to any of your income. Some states of the United States do not honor the provisions of tax treaties.

This page provides links to tax treaties between the United States and particular countries. For further information on tax treaties refer also to the Treasury Department's Tax Treaty Documents page.

A

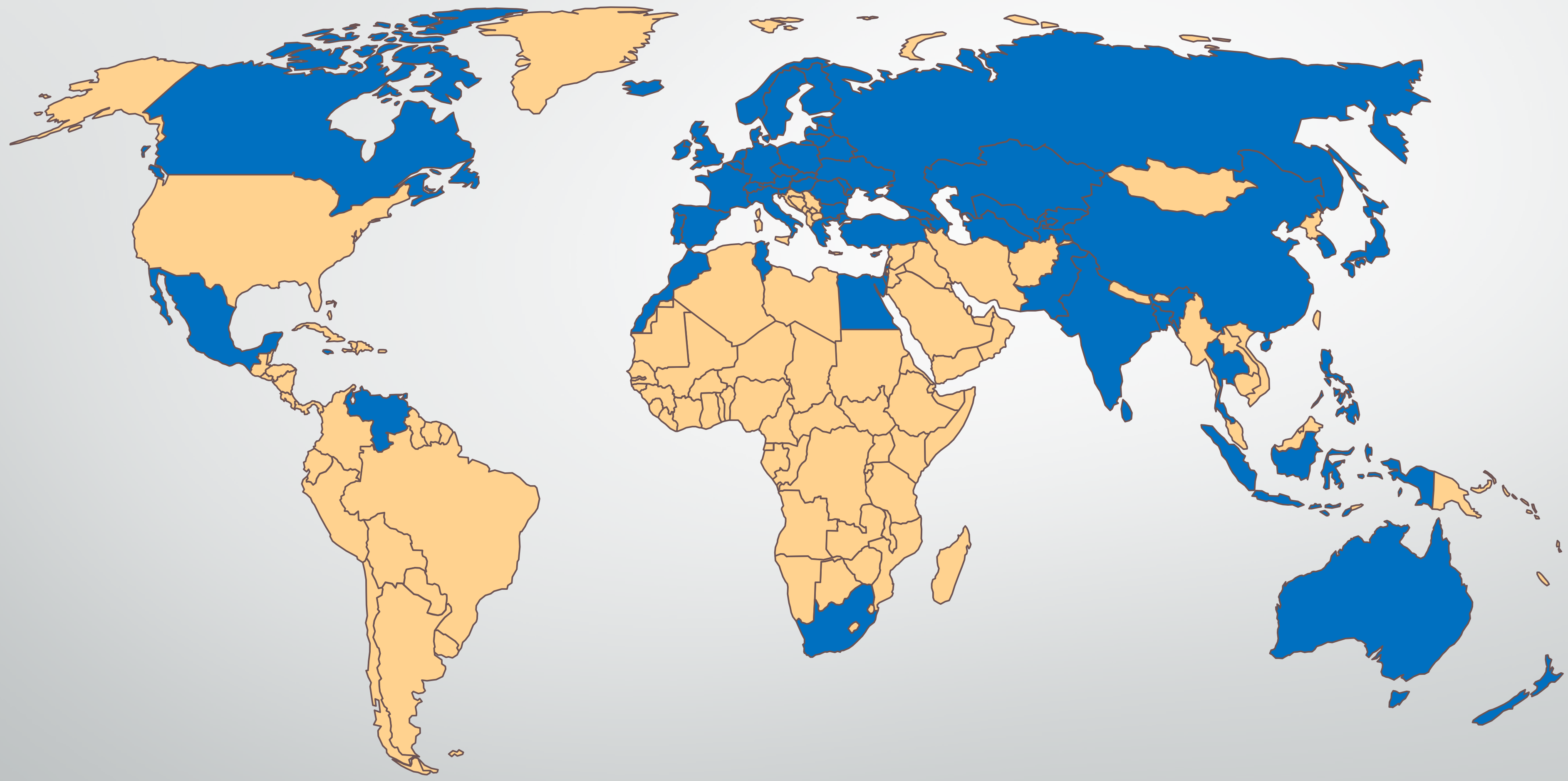
Armenia
Australia
Austria
Azerbaijan

B

Bangladesh
Barbados
Belarus
Belgium
Bulgaria

Available at http://ow.ly/TGSdp

U.S. Income Tax Treaty Partners



Selected Treaty Articles

- Article 2—Taxes Covered
- Article 3—General Definitions
- Article 4—Resident
- Article 5—Permanent Establishment
- Article 6—Income From Real Property
- Article 7—Business Profits
- Article 12—Royalties
- Article 13—Gains
- Article 15—Directors' Fees
- Article 16—Entertainers and Sportsmen
- Article 20—Students and Trainees
- Article 22—Limitation on Benefits
- Article 23—Relief From Double Taxation
- Article 25—Mutual Agreement Procedure

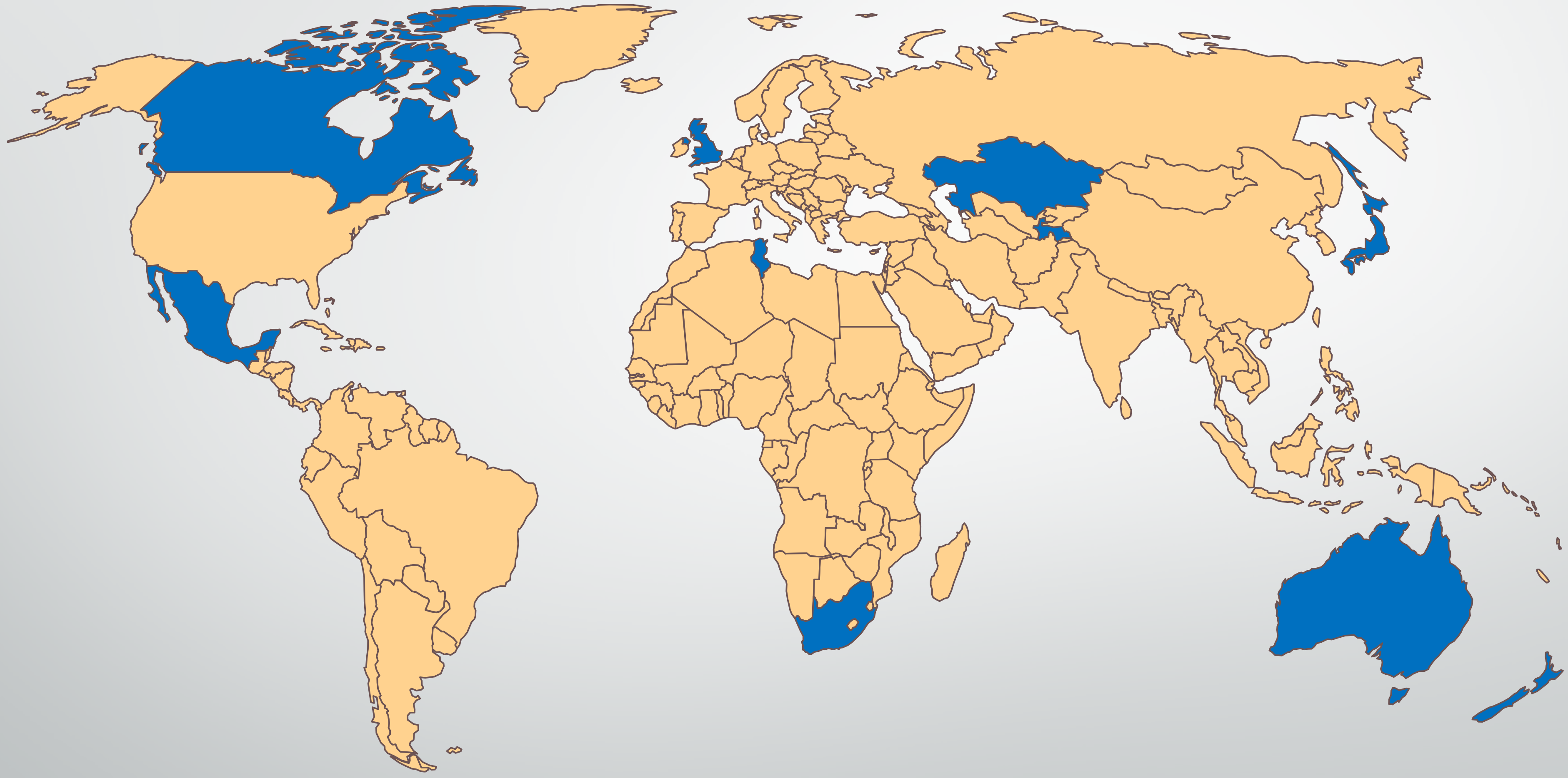
2016 U.S. Model Treaty Updates

- On February 17, 2016, Treasury released a new U.S. Model Income Tax Treaty.
  - New Article 1 Paragraph 7—Exempt Permanent Establishments
  - New Article 3 Paragraph 1(l)—"Special Tax Regime"
  - Changes in Articles 10, 11, & 12—Payments to Expatriated Entities
  - Changes to Article 22—Limitation on Benefits
  - New Article 28—Subsequent Changes in Law

Treaty Comparison

- Australia (effective Dec. 1, 1983, Protocol Jan. 1, 2004)
- Canada (effective Jan. 1, 1985, Protocols Jan. 1, 1996, Dec. 16, 1997, and Jan. 1, 2009)
- Japan (effective Jan. 1, 2005)
- Kazakhstan (effective Jan. 1,1996)
- Mexico (effective Jan. 1, 1994, Protocols Oct. 26, 1995 and Jan. 1, 2004)
- New Zealand (effective Nov. 2, 1983, Protocol Jan. 1, 2011)
- South Africa (effective Jan. 1, 1998)
- Tajikistan (U.S.-U.S.S.R. Income Tax Treaty) (effective Jan. 1, 1976)
- Tunisia (effective Jan. 1, 1990)
- United Kingdom (effective Jan. 1, 2004)

U.S. Income Tax Treaty Comparison



Dividends (Article 10)

- Tax Rate on Dividends Paid by U.S. Corporations
  - No Treaty—30%
  - Model Treaty—5% if owner has 10% ownership, 15% otherwise
  - Australia—15%
  - Canada—15%
  - Japan—10%
  - Kazakhstan—10%
  - Mexico—10%
  - New Zealand—15%
  - South Africa—15%
  - Tajikistan—30%
  - Tunisia—15%
  - United Kingdom—15%

Interest (Article 11)

- Tax Rate on Interest Income Paid by U.S. Obligors
  - No Treaty—30%
  - Model Treaty—15%
  - Australia—10%
  - Canada—0%
  - Japan—10%
  - Kazakhstan—10%
  - Mexico—15%
  - New Zealand—10%
  - South Africa—0%
  - Tajikistan—0%
  - Tunisia—15%
  - United Kingdom—0%

Income From Employment (Article 14)

- No Treaty
  - The recipient is present in the U.S. no more than 90 days during taxable year.
  - The service income does not exceed $3,000.
  - Services are performed as an employee with a nonresident alien, foreign partnership, or corporation not engaged in a U.S. business, or with a U.S. citizen, resident, domestic partnership or corporation for its foreign office.
- $10,000 exempt if present in U.S. for no more than 183 days, not paid by a U.S. resident, and is not borne by a Permanent Establishment
  - Canada
- Exempt if present in the U.S. for no more than 183 days
  - Tajikistan

Income from Employment (Article 14)

- Model Treaty
  - *the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable year concerned*
  - *the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State*
  - *the remuneration is not borne by a permanent establishment which the employer has in the other State.*
  - Mexico
  - Japan
  - Kazakhstan
  - Australia
  - New Zealand
  - South Africa
  - Tunisia
  - United Kingdom

Pensions & Annuities (Article 17)

- Tax rate on non-governmental pensions & annuities
    - No Treaty—30%
    - Model Treaty—15%
    - Australia—0%
    - Canada—15%
    - Japan—0%
    - Kazakhstan—0%
    - Mexico—0%
    - New Zealand—0%
    - South Africa—15%
    - Tajikistan—30%
    - Tunisia—0%
    - United Kingdom—0%

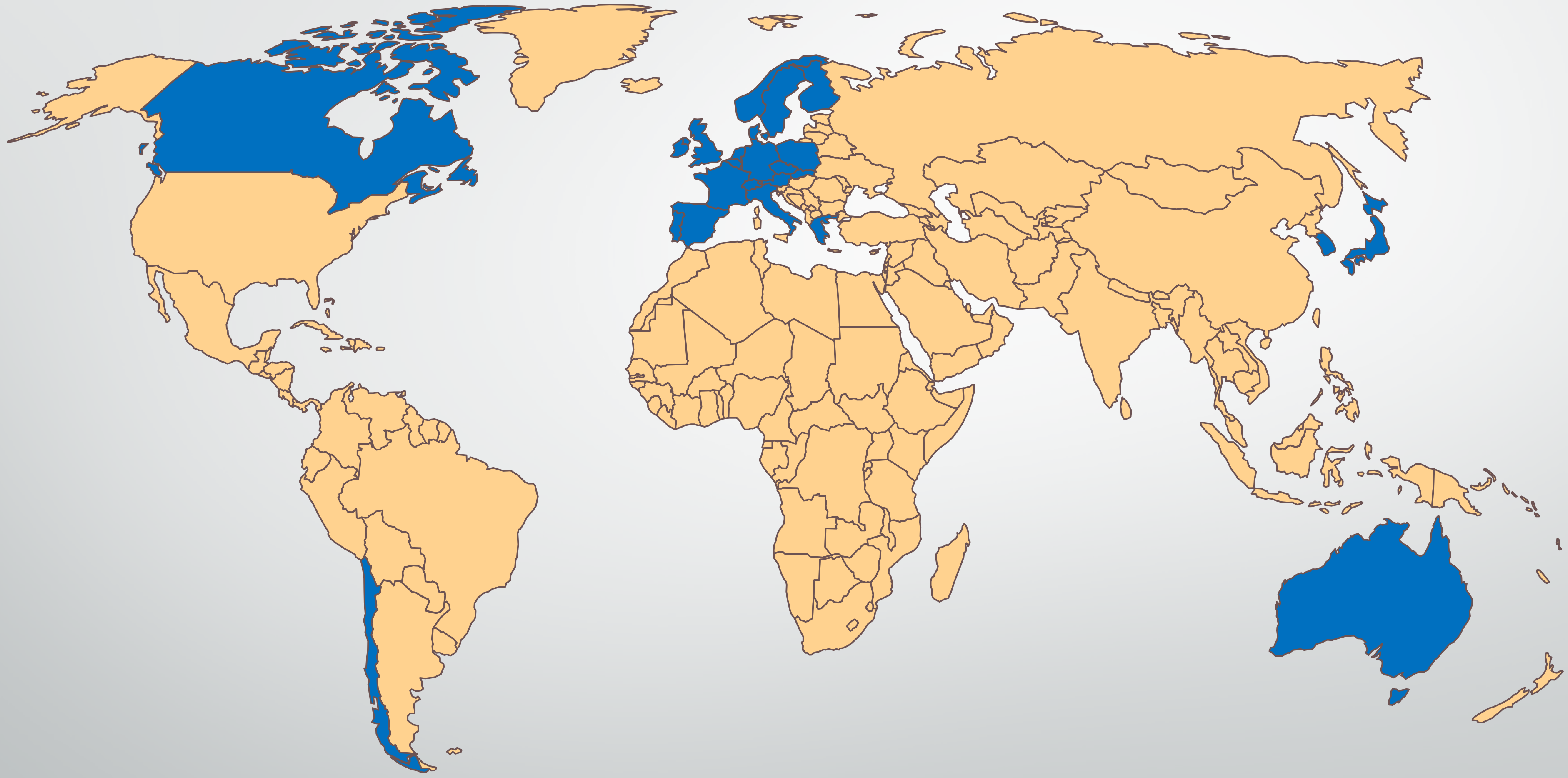
Pensions & Annuities (Article 17)

- Tax rate on U.S. Social Security Payments
  - No Treaty—30%
  - Australia*—30%
  - Canada*—0%
  - Japan*—0%
  - Kazakhstan—30%
  - Mexico—30%
  - New Zealand—30%
  - South Africa—30%
  - Tajikistan—30%
  - Tunisia—30%
  - United Kingdom*—0%
- * Has a Totalization Agreement with the U.S.A.

Totalization Agreements

- The U.S.A. is a party to 25 Social Security Totalization Agreements.
- These agreement ensure coordination between the social security programs of two countries when a taxpayer in one nation works in the other country.
- If a taxpayer is unable to qualify for social security/pension benefits in one country, Totalization Agreements allow credits earned in the other country to be used for qualification in the other country.

Totalization Agreements



Question 8

Billy, have you told the IRS about your assets?

Reporting Obligations

No additional tax is imposed, but penalties are imposed for non-filing

- FinCEN 114—Foreign Bank Account Report ("FBAR") to report foreign bank accounts with more than $10,000
- IRS Form 926—Return by a U.S. Transferor of Property to a Foreign Corporation
- IRS Form 3520—Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
- IRS Form 3520-A—Annual Information Return of Foreign Trust With a U.S. Owner
- IRS Form 8621—Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund
- IRS Form 8858—Information Return of U.S. Persons With Respect To Foreign Disregarded Entities
- IRS Form 8865—Return of U.S. Persons With Respect to Certain Foreign Partnerships
- IRS Form 8938—Statement of Foreign Financial Assets

Because of space limitations, this list doesn't attempt to be complete

Question 10

What do you mean that you didn't tell the IRS about every last thing you own on Earth?

Resolving Unmet Reporting Obligations

- Unofficial Options
  - Head in the sand
  - Quiet Disclosures
  - Noisy Disclosures
- Delinquent FBAR Submission Procedures
- Delinquent International Information Return Submission Procedures
- Streamlined Filing Compliance Procedures
  - Streamlined Foreign Offshore
  - Streamlined Domestic Offshore
- Offshore Voluntary Disclosure Program

Question 5

Billy, what do you own?

Transfer Tax Residents

- Transfer Taxes are imposed on U.S. citizens and residents
- Residents are those who are domiciled and primarily residing in the U.S.A. with no definite present intention of leaving, regardless of the time actually present. Treas. Reg. §§ 20.0-1(b), 25.2501-1(b).
- Not a bright-line rule like the Substantial Presence Test, but a facts-and-circumstances test
- All others are considered a "nonresident not a citizen of the United States"

U.S. Estate Taxation of Nonresidents

- Estate Tax applied to property located in the U.S.A.
  - Stock in U.S. corporations (whether or not publicly traded)
  - Real property in the U.S.A.
  - Tangible property in the U.S.A. (e.g., cash in a safe deposit box)
  - Uncertain treatment of foreign partnership interests
  - Revocable trusts
  - $60,000 estate tax exemption
  - Nonrecourse debt on U.S. property results in only net value included in U.S. estate

U.S. Estate Taxation of Nonresidents

- Unlimited marital deduction is available for assets left to U.S.-citizen spouses.
  - A “QDOT” can be established for non-citizen spouses
- Deductions available for charitable contributions and estate administration expenses
  - The deduction is a based on a ratio of U.S. assets to worldwide assets
- Donees take stepped-up basis in transferred property
- DSUE is not available for nonresident non-citizens.

U.S. Gift Taxation of Nonresidents

- Gift Tax applied to property located in the U.S.A.
  - Real property in the U.S.A.
  - Tangible property in the U.S.A. (e.g., cash in a safe deposit box)

U.S. Gift Taxation of Nonresidents

- No lifetime exemption
- $15,000 Annual Exclusion for gifts to non-spouses in 2020
- $157,000 Annual Exclusion for gifts to non-citizen spouses in 2020
- Unlimited marital deduction for gifts to citizen spouses
- Unlimited exclusions for educational and medical payments
- Donees take a carryover basis in transferred property
- The GST Tax applies if the Estate & Gift Taxes apply
    - $1,000,000 GST exemption(?)

Question 6

Billy, did you tell me where you're from?

U.S. Estate & Gift Tax Treaties

Corporations
Partnerships
International Businesses
Small Businesses & Self-Employed

Small Business/Self-Employed Topics

- A-Z Index for Business
- EINs
- Forms & Pubs
- Industries/Professions
- Online Learning
- Operating a Business
- Self-Employed
- Starting a Business

Estate & Gift Tax Treaties (International)

Country	Separate Estate	Separate Gift	Combined E & G	Other	Signed	Transfers made on or after:	Comments	
Australia	No	Yes	No	No	5305	12/14/53		PR-UC
Australia	Yes	No	No	No	5305	01/07/54	old *	PR-UC
Austria	No	No	Yes	No	8206	07/01/83	new *	
Belgium	Yes	No	No	No	5405	not yet	old	no effect
Canada	No	No	No	1995 Protocol	9503	11/09/95 **	estate tax only	PR-UC
Denmark	No	No	Yes	No	8304	11/07/84	new	
Finland	Yes	No	No	No	5203	12/18/52	old	PR-UC
France	No	No	Yes	No	7811	10/01/80	new	PR-UC (Protocol)
Germany	No	No	Yes	No	8012	01/01/79	new	PR-UC (Protocol)
Greece	Yes	No	No	No	5002	12/30/53	old	PR-UC
Ireland	Yes	No	No	No	4909	12/20/51	old	
Italy	Yes	No	No	No	5503	10/26/56	old	PR-UC
Japan	No	No	Yes	No	5404	04/01/55	old	PR-UC
Netherlands	Yes	No	No	No	6907	02/03/71	new	
Norway	Yes	No	No	No	4906	12/11/51	old	PR-UC
South Africa	Yes	No	No	No	4704	07/15/52	old	
Sweden	No	No	Yes	No	8306	09/05/84 (through 12/31/07)	new (terminated 01/01/08)	
Switzerland	Yes	No	No	No	5107	09/17/52	old	PR-UC
U.K.	No	No	Yes	No	7810	11/11/79	new	

* old or new refers to whether the treaty has the "old" situs rules, or the "new" provisions that generally restrict the U.S. to taxing nonresident aliens' U.S. real estate and business property.

** the 1995 Protocol had retroactive effect to TAMRA. Claims for refund based upon the treaty had to be filed by 11/09/96.

"**PR-UC**" in comments section above refers to a pro-rata unified credit provision. (The pro-rata unified credit provisions in the German and French treaties apply only to estate tax, not to gift tax.)

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Page Last Reviewed or Updated: 04-May-2016

Related Topics

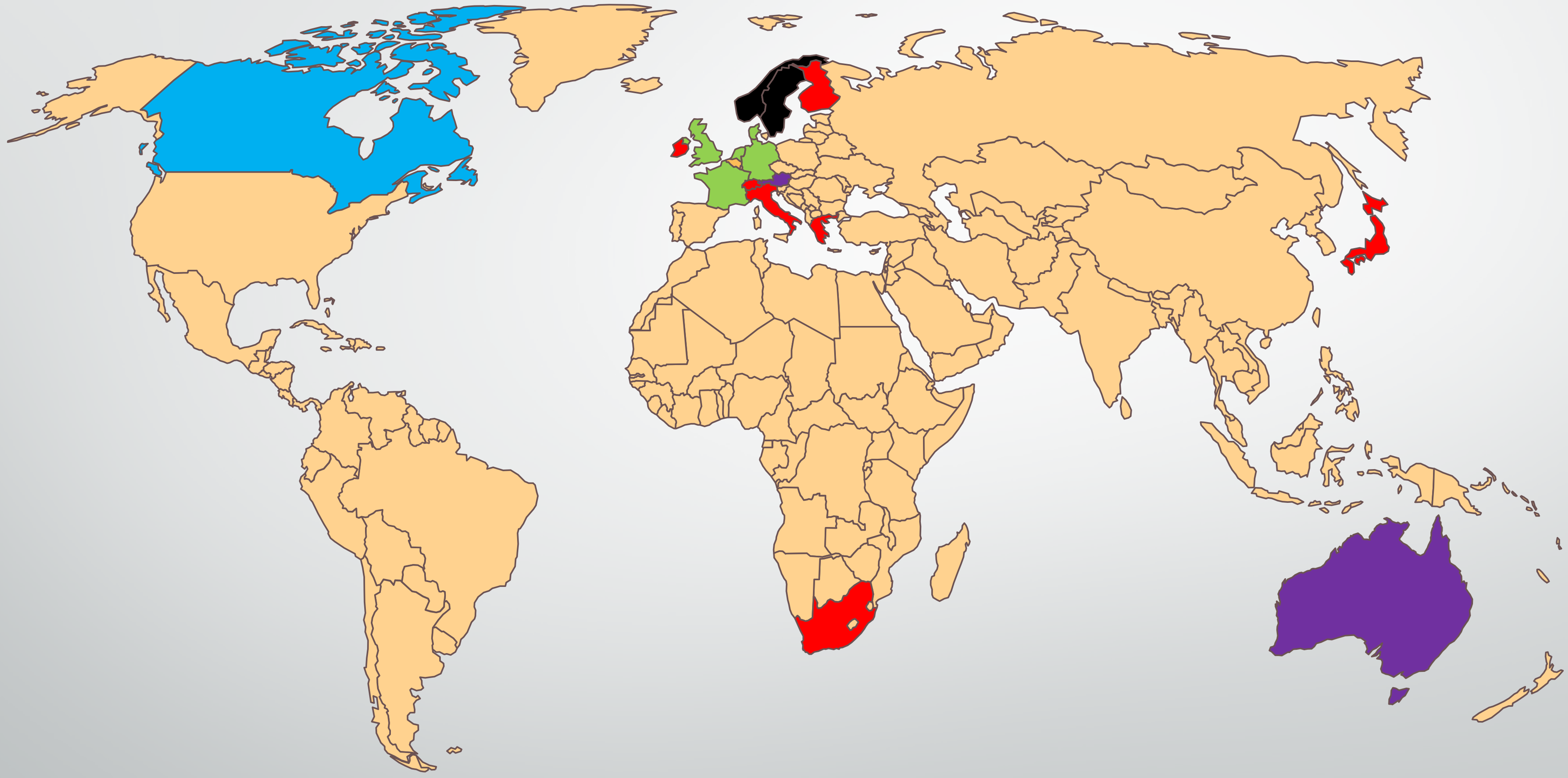
› Estate and Gift Taxes

No longer available. ¯_(ツ)_/¯

Estate & Gift Tax Treaties

- 7 Situs-Type Treaties
  - Allocation taxation of assets to jurisdictions based on the situs of the assets.
  - Treaties with ~~Australia~~, Finland, Greece, Ireland, Italy, Japan, ~~Norway~~, South Africa, & Switzerland.
- 6 Domicile-Type Treaties
  - Allocate taxation of assets to jurisdictions based on the domicile of the taxpayer.
  - Treaties with ~~Austria~~, Denmark, France, Germany, Netherlands, ~~Sweden~~, & the United Kingdom.
  - Protocol Amending United States-Canada Income Tax Treaty.

U.S. Estate & Gift Tax Treaty Partners



Question 7

Billy, do you have any assets located in the European Union?

Brussels IV

- The Succession Regulation, Regulation No 650/2012, became effective on August 17, 2015.
- It attempts to harmonize succession law in the EU by allowing testators to elect in writing to have their national law apply to the disposition of property in EU member states
  - The United Kingdom, Ireland, and Denmark opted out of the application of the Succession Regulation.

Question 8

But what about your foreign corporate entities?

Imputed Income from Foreign Entities

- Controlled Foreign Corporations (CFC)
- PFICs
- GILTI

Question 11

Billy, are you the beneficiary of any trusts?

Throwback Tax

California has its own Throwback Tax, and it is different from the Federal Throwback Tax

Question 12

Billy, are you expecting any gifts from Covered Expatriates?

Our New Inheritance Tax

- Code § 2801 imposes a 40% inheritance-style tax on transfers from Covered Expatriates to Estate & Gift Tax Residents.
- The annual exclusion applies, but the medical and education exemptions don't apply.
- The tax is not imposed if the transferor files Form 706 or 709.
- This will not be imposed until the Treasury Regulations have been finalized.
- Example: $50,000 gift for tuition paid directly to the institution
  - After the $14,000 annual exclusion, $36,000 remains subject to tax.
  - 40% x $36,000 = $14,400 tax that Billy, not the transferor, must pay.

Question 13

Billy, have you had enough?

Expatriation

- "Covered Expatriates" under Code § 877A includes U.S. citizens and long-term U.S. residents who cease to be permanent U.S. residents.
- Three-prong test to not be a Covered Expatriate
  - Average annual net income tax bill for the five prior years ending before expatriation under $171,000 in 2020
  - Net worth under $2,000,000 on date of expatriation
  - Certify on Form 8854 that you've complied with all U.S. federal tax filing obligations
- Tax on mark-to-market valuation of assets on the day before expatriation.

Takeaways

- The rules are usually upside down and backwards when dealing with international transactions.
- Even if your clients aren't dealing with international tax issues, their children almost certainly will.
- Brussels IV makes it easier to coordinate the disposition of property in the EU (except for the UK, Ireland, & Denmark).
- The Foreign Tax Credit is far easier to obtain than the Foreign Earned Income Exclusion.
- If property crosses a border, it probably needs to be reported.