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Foreign affairs: A primer on international tax and estate planning (Part 2)

15 SEPTEMBER 2017

CATEGORY:
ARTICLE

CLIENT TYPES:
HIGH-NET-WORTH INDIVIDUALS

BENEFICIARIES AND HEIRS

LEADERS AND SENIOR EXECUTIVES

PROFESSIONAL ADVISORS

Originally published by Bloomberg BNA/Tax Management Estates, Gifts, and Trusts Journal.

This is the second in a series of articles providing a primer on international planning for domestic estate planners and tax practitioners. This series is intended to assist domestic advisors in identifying pitfalls that may unexpectedly arise during the course of a representation and in recognizing opportunities that can be leveraged for the internationally connected client. Our first installment addressed the international tax paradigm as it applies to individuals, in particular addressing the U.S. income, estate, and gift taxation of nonresident alien individuals (NRAs) and trusts established by them or for their benefit.

This second installment is intended to provide an overview of various specialized tax regimes that apply to cross-border transactions. These regimes — the special taxes imposed on U.S. expatriates, the corporate anti-deferral regimes for controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs) and the withholding tax regime applicable to foreign investment in U.S. real estate — are intended to address certain historical transactions and structures perceived as abusive or potentially abusive. Perhaps unsurprisingly, the manner in which these regimes address those perceived abuses is not always intuitive (or effective), and practitioners should proceed deliberately in planning scenarios that implicate these issues.

As important as it is to be aware of potential pitfalls, practitioners should also be aware of the value that can be added by skillfully and proactively navigating the application of these regimes. Particularly in the context of international investment, it is often the case that, absent effective structuring at the outset, foreign investors are at a competitive disadvantage to their domestic counterparts insofar as taxation is concerned. Skillful and creative planning can have the effect of placing international investors entangled with the U.S. tax system in a place of parity as compared to their domestic counterparts and, in some circumstances, can place them in an even more favorable position. Although an exhaustive discussion of the myriad structuring alternatives available to international investors is beyond the scope of this article, this installment attempts to provide some context as to why these rules exist and how they function, and to identify some of the opportunities available in crossborder transactions.

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