

# Inbound tax planning

The importance of properly advising foreign investors **Interviewed by Steve Trusty**

**S**outh Florida's multicultural and international business environment continues to make this an area that is on the radar scopes of large multinational corporate and individual investors. Unfortunately, the failure to plan adequately for the tax consequences of U.S.-based investments can result in unforeseen tax liabilities and disclosure requirements.

"Inbound tax planning is the tax planning that is done before a foreign investor makes an investment commitment in the U.S.," says Michael Spritzer, senior tax partner at Berenfeld, Spritzer, Shechter & Sheer, LLP.

*Smart Business* talked to Spritzer about his methodology when dealing with foreign investors.

## What do foreign clients need to know about U.S. tax laws?

Foreign investors need to understand the basics of the U.S. tax system in order to analyze how investments in the U.S. may impact their global tax strategies. An experienced international tax practitioner can propose alternative tax structures, based on a solid understanding of the client's global structure. Understanding the tax attributes of corporations, partnerships, trusts and holding companies, the rates of tax that are applicable to these entities, and the applicable disclosures and withholding requirements is necessary for the foreign investor to make an informed decision.

## Why is it important to educate the client early?

There are multiple structures available to the foreign investor. Unfortunately, once a structure has been agreed upon, it may not easily be unraveled. For example, if a corporate structure has been established and it is later determined that a partnership or pass-through entity is preferable, there most likely would be a tax cost associated with the conversion from one entity to another. If there is need to repatriate funds from a U.S. subsidiary to a foreign parent,



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a debt equity structure should be considered at the outset to allow for the tax-free repayment of loan principal. The evaluation of potential income tax treaties should be considered prior to finalizing a tax structure.

## How do you determine the best tax entity to use?

The legal and tax attributes of entities outside the U.S. are not always the same as comparable entities inside the U.S. It is important to understand that subtle legal differences can effect the tax-planning process. For example, an LLC, which is a pass-through entity in the U.S., may be treated as a corporation in a foreign jurisdiction. In such instances, double taxation or the ability to use foreign tax credits may impact tax liabilities in the foreign jurisdiction. It is vitally important that the differences are recognized at an early stage in the planning process.

## What about transfer pricing issues?

Perhaps the most difficult area of inbound tax planning today involves the issue of transfer pricing — the pricing of

transactions between two related entities, one in the U.S. and one located in a foreign jurisdiction. The IRS is very sensitive to the fact that foreign investors may try to manipulate their profits in the U.S. by using favorable pricing structures with related overseas companies. In order to discourage this practice, the IRS has the authority to assess significant financial penalties if it believes that an abuse has occurred. In order to ensure compliance with the spirit of the transfer pricing rules, clients must be advised that related party transactions between a U.S. corporation and a related foreign entity must be separately disclosed to the IRS as part of the corporation's annual tax return filing.

## What about filing requirements?

The foreign individual making an investment in his own name usually has a U.S. tax return filing requirement. Oftentimes, the foreign investor is reluctant to file such a tax return for fear of disclosure in his or her country of origin. In such cases, even though individual ownership may have the most income tax efficient result, an alternative tax structure might have to be considered in order to give the investor peace of mind. Layering a corporation or trust between the individual and the investment may increase anonymity but reduce tax advantages.

In summary, the tax professional will want to come up with a structure that incorporates flexibility as well as domestic and global tax efficiencies. Consideration must always be given to tax and nontax issues in order to determine the best course of action.

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