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U.S. Estate Planners and Foreign Property: Part 2

Income tax considerations

Last month, we discussed domestic and international laws and tax rules that may apply to your clients who own foreign property or make foreign investments. Now, we consider the income tax consequences of owning foreign property or making foreign investments.

Passive Portfolio Investments

Like the United States, most foreign countries impose withholding taxes on the gross amount of dividends paid to foreign shareholders or interest paid to foreign account holders. Withholding rates often range from 20% to 35%. Most importantly, withholding rates are often reduced and sometimes eliminated altogether when paid to individuals eligible for benefits under a bilateral income tax treaty with the United States. The United States has currently entered into roughly 58 income tax treaties (although none in Latin America or the Middle East nor with either Hong Kong or Singapore).

If U.S. taxpayers are required to pay foreign income taxes, they're generally allowed to claim a credit against their U.S. income tax for income taxes paid to or withheld by a foreign country on the same income.

Some countries don't impose a tax on capital gains realized from the sale of public or privately issued shares by non-resident shareholders. Other countries do impose a tax on capital gains. A few countries impose an exit or departure tax on appreciated assets.[1]

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Many of the newer model Organisation for Economic Co-operation and Development (OECD) tax treaties entered into by the United States provide that capital gains arising from the sale of real property or all or any part of a permanent establishment may be taxed in the source country. However, all other capital gains under these newer OECD model treaties may only be taxed in the country where the individual realizing the gains is resident.

U.S. Anti-Deferral Tax Regimes

The jurisdiction of the United States to tax foreign corporations is limited, even if the corporation is owned by U.S. persons. Nevertheless, the United States has employed a myriad of taxing regimes under which U.S. persons are subject to U.S. tax based on their ownership of stock in a foreign corporation. These U.S. anti-deferral tax regimes include the controlled foreign corporation (CFC) regime of Subpart F and the passive foreign investment company (PFIC) regimes. The most recent addition to this slate of anti-abuse provisions is the global intangible low-taxed income (GILTI) tax, see below, which now brings active business income within the CFC anti-deferral tax regime. Given the breadth of the new GILTI provisions, which exclude only a deemed return on depreciable tangible property, the reality for many U.S. taxpayers is that the U.S. international tax regime is a worldwide full inclusion system.

CFC Anti-Deferral Regime

When a U.S. person owns a controlling interest in a closely held business or investment structure in a foreign country, there are numerous U.S. tax implications that must be considered. It's beyond the scope of this article to detail the intricate rules applicable to a U.S. controlled foreign corporation