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Welcome

It is our pleasure to present to you this inaugural issue of Holtz Rubenstein Reminick's *International Tax Adviser*.

We understand the challenges that face businesses with operations outside the United States as well as those that face foreign companies trying to establish operations inside our country. Any company contemplating the establishment of a multinational organization or any individual who owns property in another country will encounter tax rules and regulations that seem bewildering in any tongue.

Whether it is your company, or that of a client doing business overseas, we hope this newsletter gives you some ideas about navigating through international waters.

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Avoiding Penalties on "Foreign" Investment Activity

The tax compliance requirements of operating and investing overseas can be challenging for any business. Understanding the requirements isn't much easier for tax professionals, either. Let's discuss it.

You must first determine whether you engage in what the taxing authorities consider "foreign activities." These activities could be investing in a foreign partnership, purchasing an ownership interest in a foreign corporation, being owned by a foreign entity, or holding a board member position or an executive position in a foreign corporation (regardless of whether you have an ownership interest). It could even be as little as having signature authority or a financial interest in a foreign bank account. Each of these "foreign" activities can give rise to a reporting and/or filing requirement.

Tax professionals can assist you in assessing your filing requirements, collecting and processing the appropriate financial data, and filing the appropriate forms and disclosures. *The penalties in this area can be onerous.* In recent years, the Internal Revenue Service ("IRS") has devoted more attention to penalizing late filings of tax information returns. The IRS can and often will impose penalties, regardless of whether there is any actual tax due. Here are brief descriptions of a few of the most commonly used forms in international tax compliance, to help you determine your filing requirements and the potential penalties.

Form 926: Reporting of Property Transferred to Foreign Corporation by U.S. Transferors

This form may be required as soon as you invest in an overseas corporation. It captures information regarding transfers of cash or property that result in the transferor holding 10% or more of the value of a "foreign" entity. The penalty for failure to file this form can run as high as 10% of the fair market value of the property at the time of the transfer.

Form TD F 90-22.1: Report of Foreign Bank and Financial Account

If you have signature authority over (or a direct or indirect financial interest in) a foreign financial account, you are required to report certain information about each account on or

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Gifts and the U.S. Tax Consequences to Resident and Non Resident Aliens

Everyone loves to receive a gift. But often we overlook or never even consider the tax consequences that may be imposed on the gift itself.

Defining “resident”

Most of these consequences are imposed on the person making the gift – the donor. But sometimes, the tax consequences are placed on the person receiving the gift – the donee. The rules get more complicated when a non-resident alien is the donor. Certain individuals who are resident in the U.S. for income tax purposes may not be resident here for gift tax purposes. Individuals who may not be sure if they are resident in the U.S. for gift purposes should consult with their tax advisors. Green card holders will be considered resident in the U.S. for gift tax purposes even if they are not physically in the U.S.

Gift taxes

The U.S. imposes a gift tax on lifetime transfers of property wherever located by resident aliens and U.S. citizens (“U.S. persons”). If a U.S. person makes a gift to anyone, that gift should be reported on Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*. There are exceptions to the reporting requirement if each

gift for the tax year qualifies for the annual exclusion and no gift in that year exceeds the annual exclusion (currently \$12,000).

If a U.S. person receives a gift from a foreign individual, trust, corporation or other entity, the U.S. person is required to report that gift on Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*.

The purpose of this reporting is not to disclose the identity of the person making the gift, but rather to make sure that there has not been income distributed from an entity to the U.S. person which is being disguised as a gift. If the donee receives a gift in excess of

\$100,000 from an individual, the gift is required to be disclosed on Form 3520. No disclosure as to the identity of the donor is required. If a gift is made from a corporation or a partnership and exceeds \$13,258 (indexed annually for inflation), the gift must be reported, and the identity of the foreign entity must be disclosed.

Gifts from foreign trusts

Most of the complications in this area surround gifts made from foreign trusts. Most trust distributions will not be considered gifts, and will in fact, carry income tax consequences to the U.S. recipient of that income. It will be incumbent on the U.S. person to gather as much information about the foreign trust as he or she can to justify the tax treatment of the income received as either income, capital gain, or return of principal.

All amounts received from non-resident aliens should be disclosed to your tax adviser. There are large penalties involved for failure to properly disclose and report transfers. If a gift is received and not reported, the IRS has the authority to classify the gift as a trust distribution and charge the recipient with income and the related income tax and interest charges. Proper reporting is essential in this area. **h**



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before June 30 of the year following the preceding calendar year. The penalties for failing to prepare and file this form are severe. A non-willful failure to file the form may warrant a penalty of \$10,000. Willful violations carry a penalty of the greater of \$100,000 or 50% of the transaction amount or account balance. Criminal penalties can reach \$500,000 and 10 years in prison.

Form 8858: Information Return of U.S. Persons With Respect to Foreign Disregarded Entities

This is filed each year by U.S. persons who are “tax owners” of foreign entities that are disregarded for U.S. tax purposes. A foreign disregarded entity is an entity that was not formed or organized in the United States and is disregarded as an entity separate from its owner by virtue of the application of the “check the box” rules. The tax owner of the foreign disregarded entity is the person treated as owning its assets and liabilities for U.S. income tax purposes. Civil penalties for failure to file this form can be as high as \$50,000 and loss of 10% of foreign tax credits available.

Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations

This is due with your income tax return. For most domestic corporation shareholders, that would mean March 15, or the extended due date. For most individual shareholders, that would be April 15 or the extended due date.

Your tax professional should review the circumstances each year to determine whether filing is required, based on the transactions that individuals or entities completed in the current year – or in prior years. At a minimum, a tax professional should be advised if an entity or individual owns shares of a foreign corporation.



If you are supposed to file and you don't, you'll pay \$10,000 for each missing year. The penalties may be waived by the IRS on a showing of reasonable cause for failing to file the form. But if the taxpayer is notified by the IRS of a duty to file, the penalty is \$10,000 per month up to a maximum of \$50,000. In addition, for a late filing, or failing to file or report all necessary information, taxpayers will be subject to a reduction in otherwise available foreign tax credits.

Form 5472: Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in US Trade of Business

U.S. corporations must file Form 5472 if a foreign person owns, directly or indirectly, 25% or more of the value of the corporation. It is due by the due date of the corporate return and the form must also accompany each related party's return. Penalties could reach as high as \$10,000 for failure to file or failure to maintain records. Criminal penalties also may be imposed.

Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner (Grantor)

U.S. owners who own foreign trusts must file Form 3520-A or be subject to a penalty of 5% of the gross value of the portion of the trust assets that are treated as owned by the U.S. grantor (owner).

As you can see, reporting requirements after engaging in “foreign” business can be onerous and quite tricky. Be sure to contact your HRR international tax adviser at the first indication that you may be engaging in these types of business and investment activities. **h**

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