TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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US 12 | Australian Trust Holds LLC

For an expansion into the US is it best if your Australian trust holds LLC interests directly? Rather than going through a C-Corp?

Australian Trust Holds LLC Interests

When you expand into the US, you very quickly look at significant tax leakage and double taxation. And this despite potentially enjoying zero withholding tax (WHT). And despite potentially having NANE income under s768A ITAA97 or s23AJ / s23AH ITAA36. The reason for this tax leakage is two-fold.

1 – The tax you pay in the US doesn't go into your Australian companies' franking account and,

2 – The withholding tax you pay might give you a foreign income tax offset (FITO), which gets lost as the income is distributed to shareholders.

And so for that reason setting up a trust who holds your US business within an LLC might be a way to avoid this double taxation since the trust beneficiaries can claim a FITO for the US federal income tax the trust paid in the US.

To find out more let's talk with Bryan Kelly of Withers in Los Angeles.

Here is what we learned but please listen in as Bryan explains all this much better than we ever could.

To listen while you drive, walk or work, just access the episode through a free podcast app on your mobile phone.

Australian Trust Holds LLC Interests Directly

How does placing your US business into an LLC and holding this LLC through an Australian trust save you tax? Before we look at the answer let's start with the general rules.

General Rules in the US

1 – No imputation system, so every C-Corp pays 21% federal tax + state taxes, but if you hold 80% or more, you can consolidate and avoid double taxation. Hence only stack C-Corps if 80%+

2 – LLC is taxed like a partnership, so shareholders get taxed. So if you need a two-layered structure where you hold 100% at the top but less than 80% at the bottom, an LLC LLC is an easy way to avoid US double taxation.

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3 – The Australian – US DTA reduces the standard 30% withholding tax (WHT) to 15% (or even 5% or 0%), which sounds good, but the big question is whether the FITO will reach the ultimate owners, if it doesn't, it is only a temporary tax relief.

4 – When paying US dividends to an Australian company, the US withholding tax is 0% WHT if 80%+, 5% WHT if 10% to 79% and 15% WHT if less than 10% held.

5 – Capital gains from the sale of US shares are not taxed in the US if sold by US non-residents as long as the US entity doesn't hold land, so foreign investors in the US foten pay a lot more tax on US business profits than on the sale of a US business.

General Rules in Australia

1 – Profit distribution: If the Australian company holds 10% or more, any US profit distribution is NANE in Australia, either per Subdiv 768A when an overseas company or per 23AJ when an overseas branch.

2 – Capital gain: If the overseas entity is a company and the active foreign business asset percentage is 90% +, the capital gain is NANE per s768-520 ITAA97, and if the overseas entity is a branch, the capital gain is NANE per s23AH(3) ITAA36. And all this NANE talk sounds awesome, but wait until you distribute it. Then you get hit with marginal tax rates and no franking credits or FITO.

3 – Withholding tax: All entities get a FITO for the WHT they pay, but companies have withholding tax leakage since FITOs don't hit the franking account, so WHT paid won't result in franking credits to the ultimate shareholder.

So let's look at a few examples to show you how this works.

Examples

Let's assume that – only looking at profit distributions and not a sale:

1 – US sourced income is subject to 30% tax (21% federal + 9% state taxes)
2 – AU business income in the US is 100 dollars, assuming USD = AUD.
3 – The marginal tax rate of AU ultimate individual owners is 47%
4 – Disregarding branch profit tax in the US.

Example # 1 – Profit Distribution from 9% C-Corp Interest

Let's say an Australian entity holds 9% of a US C-Corp and receives $100 of profit.

In the US: $100 Less $30 tax = $70 dividend and $70 less 15% WHT $10.50 = $59.50 net cash arriving in Australia

In Australia if the Australian entity = company: Ultimate owners don't get a FITO for WHT, so $70 @ 25 % = $17.50 and $17.50 less FITO $10.50 = $7 Australian company tax. And then upon distribution to shareholders, $59.50 @ 45% = $27.07 and $27.07 less $7 franking credit = $20.07 individual top up tax. Total tax paid: $30 US tax + $10.50 WHT + $7 Australian corporate tax + $20.07 individual top up tax = $67.57 = effective tax rate 67.57%

And in Australia if the Australian entity is NOT a company: Ultimate owners get a FITO for WHT. $70 @ 47% = $32.90 and $32.90 less WHT $10.50 = $22.40 individual top up tax Total tax paid: $30 US tax + $10.50 WHT + $22.40 Australian individual top up tax = $62.90 = effective tax rate 62.90%

Example # 2 – Profit Distribution from 100% C-Corp Interest

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In the US: $100 Less $30 tax = $70 dividend and $70 less 0% WHT = $70 net cash arriving in Australia.

In Australia: Same outcome whether Australian entity is a company or not, since no WHT. In the company $70 NANE due to s768A ITAA97 and the upon distribution to shareholders $70 @ 47% = $32.90 individual top up tax. Total tax paid: $30 US tax + $32.90 individual top up tax = $62.90 = effective tax rate 62.90%. This example also applies if you hold an LLC interest through a C-Corp blocker.

Example # 3 – Profit Distribution from 79% C-Corp Interest through 100% Blocker

In the US: 79% so can't consolidate. C-Corp 1 $100 @ 30% tax = $70 dividend and C-Corp 2 $70 @ 30% tax ($21) = $49 dividend. No WHT.

In Australia: $49 arrives in Australia as NANE per s768A. 47% tax ($23.03) upon distribution. Ultimate tax rate is 74.03% ($30 + $21 + $23.03).

Example # 4 – Profit Distribution to Australian Company from 50% LLC

The Australian company holds 50% of an LLC.

In the US: AU Pty Ltd enters the US tax system (hence should be an Australian blocker) but will only be taxed on US sourced income, not Australian sourced income. AU Pty Ltd pays 30% tax in the US, resulting in $100 less $30 = $70 income. No WHT.

In Australia: $70 arrives in Australia as foreign income with a FITO of $30. 47% tax upon distribution. Ultimate tax rate is 62.90%. So same as if held through a C-Corp or a C-Corp holding an LLC.

Example # 5 – Profit Distribution to Australian Trust from 50% LLC

Australian business sets up a separate discretionary trust in Australia to hold the LLC interest, so ring-fenced from the rest of the Australian business, and distributes to individual beneficiaries.

The trust pays $30 US tax and beneficiaries get a FITO. Ultimate tax rate 47% (can't use a bucket company since otherwise loss of FITO).

Example # 6 – Branch Profit to Australian Trust

The Australian trust establishes a PE in the US. Ultimate tax rate 47% since the beneficiaries receive a FITO for any tax paid in the US.

Conclusion

Holding an LLC interest through a trust (Example # 5) might save substantial tax. As long as you can get the LLC to be treated as a look through for Australian tax purposes.

Foreign Hybrid Rules

How do you determine whether your LLC would be look through for Australian tax purposes? You check the foreign hybrid rules. We covered these in ep 320 with Clint Harding. They will tell you whether an LLC qualifies for a look-through approach in Australia.

MORE

[Australian Loan to US]

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[LLC Plus Blocker]

[Australian Companies in US Returns]

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