Tax Planning for US Bound Clients

International Wealth Planners
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Michael Parets
Withers LLP, Zurich Office
+41 44 488 8803 | direct
michael.parets@withersworldwide.com

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US-Bound Clients

1. US Tax Residency
   - Who are we talking about?
2. Consequences of Tax Residency
   - Why are we talking about them?
3. Planning Strategies and Opportunities
   - What can be done about it?

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Who are we talking about?

Anyone at risk of **US 'tax residency'** as a result of…

- moving to the US…permanently or temporarily
- spending a significant number of days in the US

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Why are we talking about them?

Like US citizens…US tax residents are taxed on a worldwide basis

- US Federal income tax
- US Federal transfer taxes
  - Estate tax
  - Gift tax
  - Generation-skipping transfer tax

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What can be done about it?

- Avoid US tax residency…if possible
- If US tax residency is unavoidable…
  - Avoid pitfalls
  - Minimize tax exposure during residency
  - Develop an exit strategy

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US Tax Residency

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Income Tax Residency

1. Green Card Holder (Lawful Permanent Resident)
   - Regardless of physical presence in the United States
2. Substantial Presence Test
   - Objective: day count
3. Election
   - If married to US Person

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Substantial Presence Test

- Day count
  - 183 days or more in current year <u>or</u>
  - If 31 days or more…
    - current year + 1/3 first preceding year + 1/6 second preceding year
    - safe harbour = >122 days per year
- Day count exceptions
  - Certain diplomats
  - Certain students and teachers
  - Medical conditions
- Closer connection exception
  - Less than 183 days in current year
  - Tax home in another country, plus closer connection

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Residency Start Date

- **Green card** – first day of presence as a green card holder
- **Substantial presence** – first day of presence in the year
- **De minimis presence** – an individual may be present in the United States for up to 10 days (in one trip) without triggering residency start date if closer connection to foreign tax home during that period

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Transfer Tax Residency

- Individuals *domiciled* in the US regardless of citizenship
  - Residence in the US with no definite present intention of leaving to reside elsewhere
  - Focus on subjective intent
  - Determined by **facts and circumstances**

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Domicile Test: Factors Considered

- Time spent by the individual in the US and other countries.
- Residency status of the individual in the US (green card holder or not).
- Location of the individual's family, friends and primary service providers.
- Location of the individual's religious and social activities.
- Use of a locally issued or an international driver's license.
- The individual's mailing address for financial statements.
- Location of the individual's business interests.
- Location of the individual's cherished and valuable family possessions.
- Location, size and degree of use of bank and financial accounts.
- Domicile (if any) claimed on official and estate planning documents.
- Location, relative size, cost, value and nature of dwellings.
- Jurisdictions where the individual pays taxes and files tax returns.

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Treaty Tie-Breaker Provisions

- Only apply if resident/domiciled in both jurisdictions
- Look to …
  1. Permanent home, if both or neither
  2. Center of vital interests, if not determinable
  3. Habitual abode, if both or neither
  4. Competent authorities determine by agreement

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Consequences of Tax Residency

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US Income Tax Exposure

Before US income tax residency...

- Dividends, rents, salaries, wages, premiums, annuities and interest (other than 'portfolio interest') from US sources
  - flat 30% rate collected through withholding
  - does not include capital gains
- Income connected to a US trade or business
  - taxed at regular graduated rates (currently up to 35%)
  - includes performance of personal services in the US, operation of a business in the US and the sale of US real property

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US Income Tax Exposure

After US income tax residency...

- Worldwide income and gains
- Application of US anti-deferral regimes
  - Direct or indirect interests in foreign corporation
    - \- PFIC tax and reporting regime
    - \- CFC tax and reporting regime
  - Actual or deemed distributions from foreign trusts
    - \- Throwback tax and foreign trust reporting rules
- Application of broader grantor trust rules

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US Transfer Tax Exposure

Before US transfer tax residency…

- US situs assets only

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US Situs Assets

- Estate tax
  - US real property
  - Tangible property in the US (cash, jewelry, artwork, cars…)
  - Shares in US companies
  - Securities and obligation issued by US persons (unless exempt: bank deposits and portfolio debt)
- Gift tax
  - US real property
  - Tangibles in the US
  - NOT shares in US companies or other US securities

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US Transfer Tax Exposure

After US transfer tax residency…

- Worldwide assets

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US Federal Transfer Taxes

- Estate Tax
- Gift Tax
- Generation-Skipping Transfer Tax

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Estate Tax

- Imposed at death
- Differs from an inheritance tax
- Imposed on assets owned directly and other assets and interests

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Interests Subject to Estate Tax

- Property owned at death
- Joint property interests
- Marital property (Community property)
- Revocable transfers
- Transfers within 3 years of death
- Transfers with retained interests
- Powers of appointment
- Life insurance proceeds
- Annuities

Gift Tax

- Imposed on lifetime gifts - gratuitous transfers
- Must be completed, irrevocable transfer

Generation-Skipping Transfer Tax

- Imposed at on transfers at death or during lifetime that skip a generation
- No generation-skipping transfer tax is imposed on a transfer unless an estate or gift tax is imposed on the transfer

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Special Two-Year US Transfer Tax Regime

- For 2011 and 2012
  - US$5,000,000 Exemption (Per US Person - Lifetime)
  - 35% Tax Rate (Lowest Rate Since 1931)
- For 2013 (Without Further Legislation)
  - US$1,000,000 Exemption
  - 55% Tax Rate

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Planning Strategies and Opportunities

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Initial Planning Considerations

- Identify…
  - assets
  - sources of income
  - interests and roles in existing trusts and foundation structures
  - interests in corporate structures
- Determine…
  - anticipated residency start date
  - anticipated length of stay in the US
  - need for assets and funds during residency

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Plan A: Avoid Tax Residency

- Income tax residency
  - Is substantial presence test avoidable?
  - Does an exception apply?
    - Diplomats
    - Students/Teachers
    - Medical conditions
  - Closer connection to other tax home?
  - Treaty tie-breaker?
  - Avoid green card status
- Transfer tax residency
  - Maintain existing domicile ➔ Avoid US domicile
  - Treaty tie-breaker?

Plan B

- Avoid pitfalls upon start of residency
- Minimize tax exposure during residency
- Develop an exit strategy

Before Residency…Avoid Pitfalls

- Existing Corporate Structures
  - Closely-held businesses may qualify as **CFCs**
    - Not always a bad thing - may be an opportunity to accumulate earnings and reduce or avoid US taxes
    - Consider selling or filing election to treat as partnership/disregarded entity for US tax purposes (aka ‘check-the-box’ election)
  - Offshore investments very likely **PFICs**
    - Without a mark-to-market or QEF election in place, negative treatment only realized on distribution or sale
    - Consider selling or filing mark-to-market/QEF election

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Before Residency…Avoid Pitfalls

- Existing Trust and Foundation Structures
  - **Settlor / Founder** - May be treated as grantor and owner of trust if…
    - power to add/remove beneficiaries
    - residency start date is within 5 years of transferring property to trust
  - **Beneficiary** - Actual and deemed distributions from foreign trust
    - Throwback rules
    - Reporting obligations

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Before Residency…Timing Techniques

- Accelerate income (dividend, interest, royalties, etc) from non-US sources
- Accelerate sale of assets with high built-in gain
- Defer sale of assets with built-in losses
- Make gifts of non-US situs assets

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Before Residency…Pre-Immigration Trust

Transferring assets to a properly-structured offshore trust…

- Protects against US estate tax
- May shelter income and gains from US income taxation if…
  - settlement more than 5 years from residency start date or
  - excludes US persons from ever benefiting from trust and overcomes presumption under HIRE Act that US persons may benefit

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Before Residency…PPLI

- **Private Placement Life Insurance**
  - Must avoid investor control
  - Investments in non-US investment funds (PFICs) possible
  - Taxation of investment income avoided during insured's life
  - Couple PPLI with trust structure to provide estate tax protection

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Before Residency…DVA

- **Deferred Variable Annuity** for short-term and medium-term residents
  - Must avoid investor control
  - Investments in non-US investment funds (PFICs) possible
  - Taxation of investment income deferred until annuity payment
  - May avoid US income taxation on annuity payments made after residency termination date
  - Couple DVA with trust structure to provide estate tax protection

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Residency Termination Considerations

- Terminating tax residency
- Taxation of offshore trusts
- Expatriation Exit Tax
  - Green card holders beware
- Ongoing legacies - are my children US?

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Question and Answer Session

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