

U.S. Pre-immigration Tax Panning

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OVERVIEW

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 - Taxation of Residents and Non-Resident Aliens
 - Residence
 - Taxation of Trusts, Grantors and Beneficiaries
- III. Pre-Immigration Tax Planning
- IV. Minimize Exposure to U.S. Estate, Gift and GST Taxes
- V. State and Local Tax Considerations

I. US TAX CONSIDERATIONS – IN GENERAL

- Three principal categories of U.S. tax to be considered
 - Federal income tax
 - Federal estate, gift and generation-skipping transfer tax
 - State and local income (and potentially other) tax
- Foreign country tax considerations and interaction of timing and foreign tax credits

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Taxation of Residents and Non-Resident Aliens

In General:

U.S. citizens, U.S. tax “residents” and domestic corporation are taxed on their worldwide income derived from all sources; whereas

Non-Resident Aliens are taxed on income derived from only US sources which is

- “FDAP” income (Fixed or Determinable Annual or Periodical income); or
- “ECI” (Effectively Connected Income)

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Definition for U.S. Taxation Purposes:

A resident alien of the United States is a foreign national who meets either of the following two objective tests:

- 1. Lawful Permanent Resident (“Green Card”) Test**
- OR**
- 2. Substantial Presence Test**

If a foreign national does not meet either of the above tests, he or she is considered a non-resident alien

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Test 1: Lawful Permanent Resident Test

- Also known as the Green Card Test
- Considered a resident alien from the day that he or she is admitted to the United States as a lawful permanent resident (with a "green card") until the day that this status is officially revoked or judicially abandoned
- Once you are considered a resident alien, it does not matter if you then reside outside of the U.S

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Test 2: Substantial Presence Test (“SPT”)

- He or she must be physically present in the United States for 31 days or more in the current year;
- and**
- He or she must be physically present in the United States for a weighted average of at least 183 days over a three-year testing period that comprises the current and the two preceding years.
 - All days in the current year, plus
 - 1/3 of the days in the preceding year, plus
 - 1/6 of the days in the second preceding year

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Substantial Presence Test

The following individuals are exempt from SPT:

- i. Foreign Government-Related Individual
- ii. Teacher (under a J or Q visa)
- iii. Student (F, M, J or Q visa)
- iv. Professional athlete temporarily in U.S. to compete in charitable sport
- v. Persons with a medical condition if he or she intends to leave the U.S. but is unable due to medical condition (unless in the U.S. to seek treatment regarding existing medical condition)
- vi. Persons in transit through the U.S.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Closer Connection Exception

Even if you meets the Substantial Presence Test then this exception takes you out.

Requirements:

- i. Present in U.S. for fewer than 183 days in current year, **and**
- ii. Has as a tax home in a foreign country, **and**
- iii. A closer connection to that country than to U.S.

Must not have application for adjustment of status pending or take steps towards permanent residency.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Closer Connection: Facts and circumstances include:

- i. Country of residence designated on forms and documents
- ii. Location of home
- iii. Location of the family
- iv. Location of personal belongings
- v. Location of the social, political, cultural or religious organizations with which the individual is associated
- vi. Location where conducts business activities
- vii. Jurisdiction(s) in which holds a driver's license
- viii. Jurisdiction in which the individual votes

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Residency Starting Date:

Earlier of the first day of presence as a lawful permanent resident or first day of presence in year that he or she satisfies the substantial presence test

De Minimus Exception - Can ignore up aggregate of 10 days during period taxpayer has a foreign tax home and closer connection to a foreign country.

The No Lapse Rule

- An alien individual who is a U.S. resident for any part of the current year and who was a U.S. resident during any part of the preceding calendar year will be taxable as a U.S. resident as of the beginning of the current year.
- An alien individual who is a U.S. resident for any part of the current year and who is also a U.S. resident for any part of the following year will be taxable as a resident through the end of the current year.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Elective Residence

- Can elect to be treated as resident if
 - i. Was not a U.S. resident in the calendar year immediately proceeding the election year and
 - ii. Is a U.S. resident immediately following the election year: and
 - iii. Is present in the U.S. for a period of at least 31 days in the election year and present in the U.S. during the period beginning with the first day of such 31 period and ending with the last day of the election year (“the testing period”) for a number of days equal to or exceeding 75% of the number of days in the testing period. Residence commences on the first day of the earliest such 31 day period with respect to which the 75% test is satisfied.

Also, a NRA spouse (or part year resident) may elect to be treated as U.S. resident together with the U.S. resident or citizen spouse.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Residence

Relief Under Income Tax Treaties

A foreign individual that qualifies both as a U.S. resident under section 7701(b) and, pursuant to the internal tax law of a foreign jurisdiction with which the U.S. has an income tax treaty, as a resident of such jurisdiction (a “dual resident”) might be able to claim treaty benefits to avoid U.S. federal income taxation.

In general, under a typical tie-breaker provision, exclusive residence is determined by applying the following tests in the following order:

- resident of the country in which he has a permanent home available to him; if permanent available in both treaty countries, he is deemed to be a resident only of the treaty country with which his personal and economic relations are closer (center of vital interests);
- deemed to be a resident of the country in which he has a habitual abode;
- deemed to be a resident of the country of which he is a national; and
- if the issue cannot be settled by the application of the tests set forth above, the competent authorities of the treaty countries, i.e., the IRS and its counterpart in the foreign treaty country, are required to make an effort to settle the issue by mutual agreement.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Taxation of Trusts, Grantors and Beneficiaries

Foreign Trust or Domestic Trust

A trust is a domestic trust if satisfies both:

- “Court Test” - A court within the U.S. is able to exercise primary supervision over the administration of the trust; and
- “Control Test” - One of more U.S. persons have the authority to control all substantial decisions of the trust

Grantor or Non-Grantor Trust

Under §672(f), if a trust has foreign grantor, rules are more limited than if a U.S. grantor in determining whether the trust will be treated as a grantor trust. Generally, a trust will be treated as grantor trust if:

- i. It is revocable by the grantor (either alone or with the consent of a related or subordinate party who is subservient to the grantor) or
- ii. Distributions (whether income or corpus) may be made only to be the grantor or the grantors life during the grantors lifetime.

II. U.S. FEDERAL INCOME TAX CONSIDERATIONS

Taxation of Trusts, Grantors and Beneficiaries

Foreign Non-Grantor Trust

- Taxed like a non-resident alien i.e. on certain U.S. source income
- Throwback rules on distributions of Undistributed Net Income (“UNI”) to U.S. beneficiaries
- EIN and Form 3520-A
- Form 3520 reporting by U.S. beneficiaries
- Under §679 a foreign trust established by a non-U.S. person who becomes a U.S. person within five years of transferring property is the trust, directly or indirectly, will be a grantor trust if the trust has a U.S. beneficiary

Foreign Grantor Trust

- US owner must report on Form 3520
- Trustee to provide 3520-A, EIN

III. PRE-IMMIGRATION TAX PLANNING

- i. Avoiding U.S. Residency
- ii. Income Recognition and Acceleration
- iii. Gain Recognition and Loss Deferral
 - Actual or deemed liquidation of a foreign holding company
 - Actual or deemed liquidation of a foreign operating company
 - Sale to a related person
 - Constructive sale under §1259
 - “Wash Sales” of appreciated positions
- iv. Anti-Deferral Provisions
 - Controlled Foreign Corporations
 - Passive Foreign Investment Companies
- v. Variable Annuity and Variable Life Insurance Contracts
- vi. Evaluate Trusts
- vii. Pre-immigration Trusts
- viii. Source of payments made by relocating individual

IV. MINIMIZE EXPOSURE TO U.S. ESTATE, GIFT AND GST TAX

Estate Tax

- Domiciled in the U.S. – facts and circumstances, intent
- Non-domiciled person subject to U.S. estate tax on certain property located in the U.S. (only \$60,000 exemption)
- Non-citizen spouse – Qualified Domestic Trust (“QDOT”)
- If planning to be non-domiciled
 - Try to support intent through actions
 - Avoid U.S. situs assets
 - Consider life insurance

Gift Tax

- Gifts – available annual gift tax exclusions on gifts of U.S. situs property but no gift splitting with spouse and no unified credit available
- Present interest gifts to non-citizen spouse limited to annual exclusion of \$139,000 (2012)
- Consider:
 - Avoid gifts of U.S. situs property
 - Consider gifts of non-U.S. situs property prior to immigrating
 - Careful consideration to joint accounts

Consider estate and gift tax treaties

V. STATE AND LOCAL TAX CONSIDERATIONS

- Residency rules vary by State and are not the same as the Federal rule. Needs careful consideration for someone immigrating to the U.S.

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