School of Continuing and Professional Studies
Introduction to International Taxation

MOVING TO THE UNITED STATES

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Michael Karlin and Thomas Giordano-Lascari

Karlin & Peebles, LLP
5900 Wilshire Boulevard, Suite 500
Los Angeles, CA 90036
Tel: (323) 852-0030
mjkarlin@karlinpeebles.com
tgiordano@karlinpeebles.com

Overview

- Introduction
- Key considerations and objectives
- Residence and timing
- Planning possibilities
- What to do when the client is already here

Key Considerations and Objectives

- Understand the different definitions of residence and the impact on timing of change of residence.
- Limit exposure of assets to U.S. estate and gift taxes.
- Plan for application of worldwide taxation to foreign and U.S. assets:
  - Basis step-up.
  - Loss importation.
  - Dealing with controlled foreign corporations and passive foreign investment companies (not just non-U.S. funds).
  - Deal with existing trusts and foundations.
  - Trust planning.
- Consider home country consequences of changing residence.

Pre-Residence Planning Agenda – 1

The key to planning for a prospective resident is to determine exactly when residence will begin and to carry out tax planning best undertaken before that.

- Accurately time when U.S. tax residence begins for income tax and transfer tax purposes.
- Consider carefully appropriate immigration status, given punitive rules applicable to green card holders who later become “covered expatriates” on leaving the United States.
- Accelerate collection of non-U.S. income and realization of gains not subject to U.S. tax.
- Defer realization of losses.

Pre-Residence Planning Agenda – 2

- Deal with income and gains held in deferred compensation plans and other foreign pension and savings accounts.
- Deal with holdings in foreign corporations, especially corporations that might become controlled foreign corporations or passive foreign investment companies following the beginning of residence.
- Deal with trusts that are already in existence, whether formed by the prospective resident or by the new immigrant’s family members.

Pre-Residence Planning Agenda – 3

- Make gifts and create trusts for spouse and children and otherwise take steps to keep assets from falling into the U.S. estate and gift tax net.
- Consider the possibility that residence may be temporary.
- Coordinate planning with home country advisors.

Residence and Timing

- Prior sessions have touched on the definition of residence for U.S. tax purposes
- Bear in mind:
  - Residence is defined differently for purposes of income tax and taxes on gifts and estates.
  - Residence is defined differently for purposes of Federal income tax and state income taxes.
  - There are even a number of situations where the main Federal income tax definition of residence does not apply.
  - Other countries have their own rules and it is possible that an individual may be resident in two countries or none, depending on the application of these rules.
- A more detailed summary of the rules is in the Appendix.

Timing Arrival

- Timing arrival in the United States is critical.
- For income tax purposes, arrival in 2nd half of year may make it possible to be in the United States for several months without becoming a resident (except green card holder).
- But residence may begin right away for transfer tax and state tax purposes.
- Some countries (e.g., Canada) will not treat an individual as ceasing residence there unless new residence established, but in some cases, there may be time where the individual ceases to be resident in the previous country without becoming a U.S. tax resident until the end of the year.

Green Card Test

- U.S. resident for any year in which individual holds a green card) for any part of the year. Reg. § 301.7701(b)-1(b)(1)
- Residency Starting Date:
  - First day the person is physically present in the U.S. as a lawful permanent resident. IRC section 7701(b)(2)(A)(ii); Reg. § 301.7701(b)-4(a)
  - Assumes the substantial presence test not already met.
  - Also assumes not a resident in the prior year.
- Exception:
  - If person is also a resident of a treaty country (i.e., dual-resident taxpayer) and that treaty has a tie-breaker rule. Reg. § 301.7701(b)-7

Substantial Presence Test – 1

- Must be present in the U.S. for at least 31 days in current year <u>and</u> satisfy the 183 weighted average calculation as of last day of physical presence in the current year. IRC section 7701(b)(3)(A); Reg. § 301.7701(b)-1(c)(1)
- Begin Date:
  - Use look-back rule to determine current year.
  - If satisfy test, first day will be the first day of physical presence in U.S. during calendar year in which the test is satisfied. IRC section 7701(b)(2)(A)(iii); Reg. § 301.7701(b)-4(a).

Substantial Presence Test – 2

- De Minimis Rule - Must be present in the U.S. for at least 31 days in current year to satisfy the substantial presence test. IRC section 7701(b)(3)(A)(i); Reg. § 301.7701(b)-1(c)(4)
- Nominal Presence - Up to 10 days of presence disregarded if person can establish a closer connection to a foreign country. IRC § 7701(b)(2)(C); Reg. § 301.7701(b)-4(c)(1)
  - See Appendix for more details.

Substantial Presence Test – 3

- Foreign tax home/closer connection.
- Statutory exception applies if throughout the year, the individual:
  - Has a “tax home” in another country.
  - Has a closer connection to the other country than to the United States.
  - Has less than 183 days of presence in year.
- “Tax home” does not mean tax residence in the other country. It means regular or principal place of business or, if none, regular or principal place of abode.
- Closer connection based on personal ties.

Both Tests Satisfied

What If a Person Satisfies Both Tests for the First Time in the Same Year?

The residency starting date is the earlier of (i) the first day the individual is physically present in the U.S. as a lawful permanent resident or (ii) the first day during the year that the individual is present for purposes of the substantial presence test. Reg. § 301.7701(b)-4(a).

Tax Treaty Residence Provisions

- Most U.S. tax treaties have provisions dealing with individuals who are resident in the United States and in another country.
- The treaties typically provide a series of tiebreaker tests so that the individual will be resident in one but not both.
- For incoming residents, useful mainly in delaying start of U.S. residence.
- Warning: Treaty nonresidents may still be treated as U.S. residents for reporting purposes.

Immigration Status

- We won't have time to cover the covered expatriate rules of IRC sections 877A and 2801. However, if an individual considers it likely or possible that he or she will not remain permanently in the United States, consider whether a green card is necessary.
- The covered expatriate rules apply only to a green card holder who ceases to be resident after being a lawful permanent resident **in** 8 of the preceding 15 years.

Accelerate Collection of Non-U.S. Income

- The United States taxes most individuals when income received, whether as cash or property. An intending resident should accelerate receipt of income already earned.
- How to accelerate depends on the type of income:
  - Collect compensation for services, from employment and for work as an independent contractor promptly.
  - Where possible, seek pre-payment of rents and royalties.
- In theory, this applies to pension plans and other deferred compensation. But easier said than done, because of plan terms, penalties, forfeitures and home country tax on early distributions.
- Terminate partnerships prior to residency start date to avoid including distributive share of partnership income for taxable year ending after that date.

Installment Sales – 1

- The IRS generally treats a newly resident taxpayer as if he or she had elected out of installment sale treatment in the case of pre-residence sales (IRC section 453(d); see PLR 9412008 (Dec. 20, 1993)).
  - Actual election is apparently not required, which would be difficult for sales made in years when the taxpayer had no U.S. connections.
  - Election out should be made regarding any pre-residence sale in year residence begins.
  - New resident must recognize interest related to installments; interest can be imputed and taxed if earned after residence begins.

Installment Sales – 2

- Earn-out sale
  - Should qualify as installment sale.
  - However, earn-out payments, although not taxable, must be valued as of the sale date. If amounts received in the earn-out after the beginning of U.S. residence exceed the valuation, there will be taxable gain on the difference.
  - Valuing the earn-out payments using U.S. valuation principles may therefore be desirable, the incentive being the highest sustainable value.

Accelerate Realization of Gains – 1

- No “landed basis” for assets of new resident. If an asset is sold after owner has become U.S. resident, entire amount of gain, even from appreciation from before residency began, will be recognized in full.
- Therefore, try to realize all unrealized gains.
  - Compute basis of an asset purchased in foreign currency by translating purchase price at historical exchange rate.
  - Foreign currency transactions are treated as realization events. This includes exchanging one currency for another currency, including the dollar, as well as using currency to purchase an asset.
- Marketable assets can be sold into the market.
  - Wash sale rules of section 1091 do not apply. Still, better to delay repurchasing identical securities; repurchase similar but not “substantially identical” securities.

Accelerate Realization of Gains – 2

- Less liquid assets present greater challenges, especially those which taxpayer wants to retain long term. Be wary of sales to related parties or accommodators, vulnerable to challenges based on lack of substance.
- Moving foreign funds can be problematic.
  - Foreign fund will likely be a PFIC (see below).
  - Some funds allow conversion of the fund to fund designed for U.S. investors.
  - Others will provide required information to enable newly U.S. resident to make QEF election.
  - In some cases, funds must be sold or redeemed and this may require giving substantial notice.

Other Planning Ideas – 1

- Check-the-box planning
  - Checking the box on an entity classified by default as a foreign corporation should result in a step-up in basis in the underlying assets without tax, assuming the assets are not attributable to a U.S. trade or business
  - The election needs to be effective before residence begins
  - Complications can arise if
    - the underlying assets are themselves stock in corporations; or
    - there are other shareholders

Other Planning Ideas – 2

- Contribution of the assets to a corporation in a transaction deliberately designed to fail the requirements for tax-free incorporation under section 351, possibly using non-qualified preferred stock as described in section 351(g).
  - These transactions may be subject to heightened scrutiny by the IRS. However, it is doubtful that the IRS would be motivated to seek to recharacterize properly designed redeemable preferred stock as qualified preferred stock.

Deferred compensation plans; other foreign pension and savings accounts – 1

- New residents are often members of deferred compensation plans. Few plans are qualified, unless new resident worked for a U.S. company or multinational that regularly employs Americans.
- Section 409A presents particular difficulties because it may apply right from residency starting date. Possibly helpful exceptions for U.S. members of foreign plans include:
  - Exemption for plans requiring payment within 2½ months of end of 1st year compensation first becomes vested;
  - Grandfathered plan exemption, for amounts that were earned and vested prior to January 1, 2005, provided that the plan is not materially modified after October 3, 2004;
  - Regulatory exemption for foreign "broad-based" unfunded retirement plans

Deferred compensation plans; other foreign pension and savings accounts – 2

- Section 409A does not apply to plans that are fully funded.
  - Amounts contributed to the plan vest fully before U.S. residence begins are exempt from U.S. income tax to the extent related to non-U.S. services.
  - Distributions while individual is a U.S. resident taxable in the normal way.
  - Employer contributions during U.S. residence will be taxed to the individual unless the plan becomes qualified.

Deferred compensation plans; other foreign pension and savings accounts – 3

- Pension plans and savings accounts will generally not have been designed to meet U.S. requirements.
  - Individual who becomes a U.S. resident may become taxable on income earned by the plan or account even though terms do not allow withdrawal of funds or would condition withdrawal on significant fees or penalties.
  - Even if the design of plan or account is such that the individual would not be taxable on plan income, he or she will become taxable once plan pays out benefits at any time after income tax residence has begun, at least to the extent benefits are attributable to income earned by plan.
  - IRC section 72(w): Payouts treated as annuities (investment in the contract does not include foreign employer contributions that were free of foreign tax)

- Ownership of any plan or account.
  - Individual beneficial owner will be taxable in the United States on income as it arises. Treaty exceptions in the case of Canadian registered retirement savings plans (RRSPs) and some other foreign plans – this is one of the relatively rare cases where a U.S. citizen or resident is allowed to rely on a treaty for U.S. tax purposes.
  - Foreign IRA equivalents, e.g., U.K. individual savings account (ISA), are treated as foreign grantor trusts, with Form 3520 and 3520-A reporting requirements.
- Where employee only has contractual right to benefits, employer or plan administrators are treated as owner of plan assets and income. Accordingly, employee/former employee taxable only when distributions are received.

Deferred compensation plans; other foreign pension and savings accounts – 5

- Simple advice: Have plan distribute assets to the individual before U.S. residence begins.
- But this advice may not be practical. Planning for foreign deferred compensation plans, pension plans and savings accounts will likely be limited by terms and limitations set by plan and foreign legislation.

Deal with Foreign Corporations

- Entity classification
  - Before planning can begin, apply U.S. entity classification rules to determine if foreign business entity is (a) a corporation or (b) a partnership or disregarded entity.
  - Foreign entity on IRS list of about 85 companies (no more than one per country) automatically (“per se”) treated as corporation.
    - No company or entity formed in an offshore jurisdiction such as Bermuda, the British Virgin Islands or the Cayman Islands is listed.
    - Panama S.A. is an exception.
  - A foreign entity not on the list is classified by default:
    - Corporation: All shareholders have limited liability for company’s recourse debts.
    - Partnership: At least one shareholder/member has unlimited liability.
  - Entity not on per se list can elect to be treated as a partnership. This so-called “check-the-box” election is a powerful planning tool for prospective residents.
- U.S. classification is controlling for state tax purposes but not for non-tax purposes or purposes of foreign tax law.

Dealing with Foreign Corporations

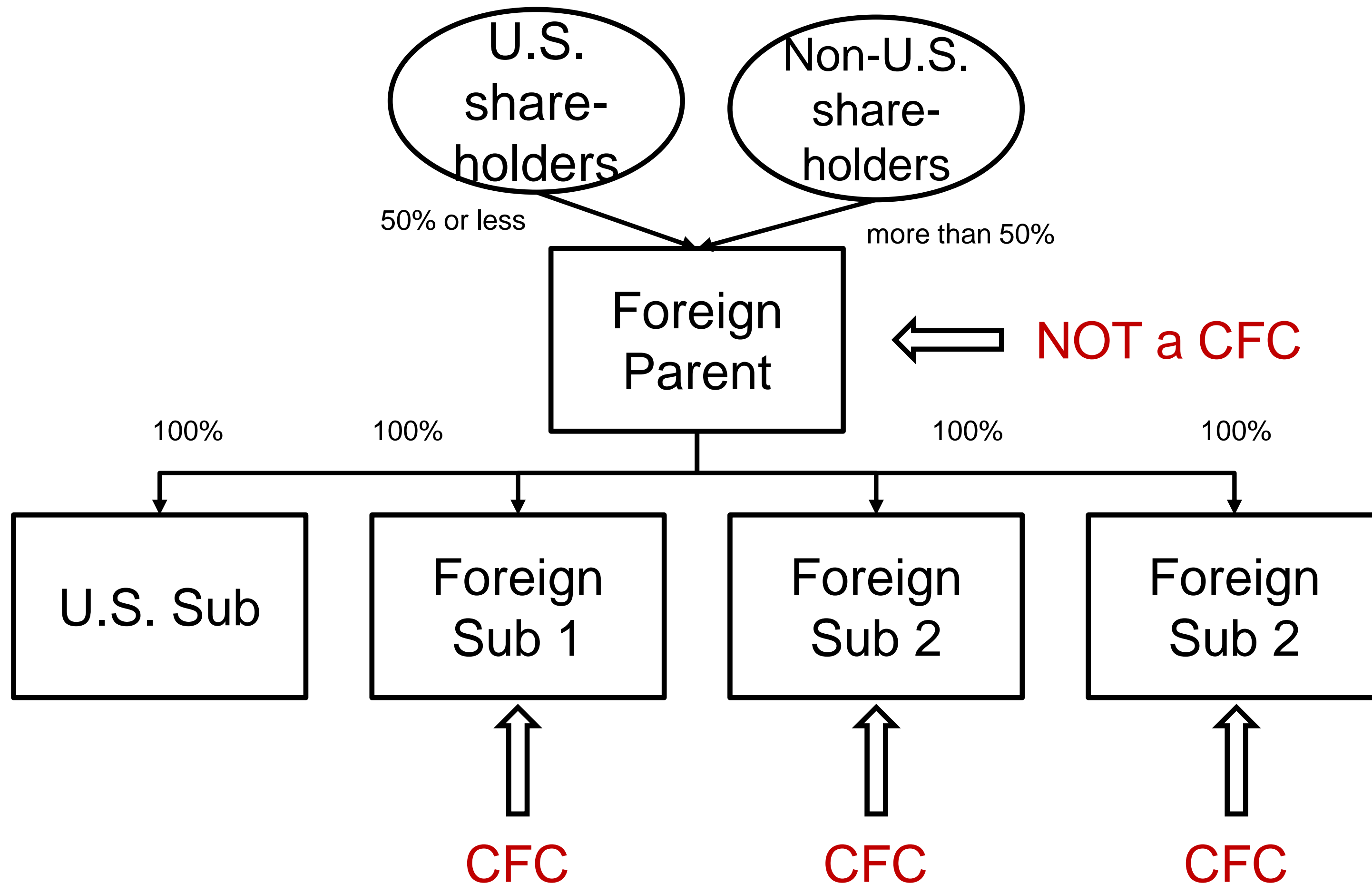
- The United States doesn't tax foreign corporations on foreign income or certain U.S.-related income.
  - This could enable U.S. persons to defer tax on foreign and even some U.S. income by earning it through a foreign corporation, with tax payable only when the U.S. shareholder receives distributions or sells the shares.
- The United States has enacted anti-avoidance measures designed to counteract deferral. The American Jobs Creation Act of 2004 contracted these measures into two regimes:
  - Controlled foreign corporation (CFC rules), directed at closely held foreign corporations.
  - Passive foreign investment company (PFIC) rules, directed at offshore funds (but applies more broadly).

Controlled Foreign Corporations – Definition

- CFCs are foreign corporations that are majority-controlled by "United States shareholders" – a U.S. shareholder is a U.S. person who owns, directly, indirectly or by attribution at least 10% of the shares of the foreign corporation.
  - For a new resident, foreign corporation may already be a CFC because of the existing composition of the shareholder body; if the new resident is a "U.S. shareholder", he will become subject to the CFC rules.
  - Alternatively, foreign corporation may become a CFC as a result of the individual becoming a U.S. resident because:
    - the individual was the majority shareholder; or
    - shareholding causes percentages of voting power or value held by all U.S. shareholders to exceed 50%.

Downward Attribution

- The 2017 Act expanded coverage of CFC rules by allowing for so-called “downward attribution”. E.g., foreign subsidiaries of foreign group with just one U.S. member may be CFCs.



Controlled Foreign Corporations – Consequences

- Main consequence: U.S. shareholder must include share of CFC's Subpart F income and "global intangible low-tax income" (GILTI) each year, with income taxed at ordinary rates.
  - Subpart F income: Passive income and certain income generated outside CFC's country of incorporation from related party business transactions.
  - GILTI refers to all other income of the CFC (less allocable deductions) reduced by 10% of adjusted tax basis of the CFC's depreciable tangible assets (generally, plant and equipment, but not land).
- Subpart F and GILTI inclusions do **not** qualify for long-term capital gains treatment. Notice 2004-70; *Rodriguez v. Commissioner* (2013).

Controlled Foreign Corporations – Planning – 1

- Analyze corporate structure and activities of foreign corporation and determine whether to employ various possible strategies, including:
  - Distribute accumulated earnings and profits to prospective resident.
  - Have foreign corporation sell or otherwise realize gain on assets and distribute the proceeds.
  - Have the foreign corporation distribute assets to the prospective resident.
  - Have foreign corporation and/or subsidiaries make a check-the-box election
  - Restructure the foreign corporate group (including inserting U.S. holding corporation).

Controlled Foreign Corporations – Planning – 2

- Once individual is a U.S. resident, consider IRC section 962 election to be taxed as a corporation on amounts included in gross income under section 951(a) and 951A and to obtain section 960 foreign tax credits.
  - Disadvantage of the election is that when corporate profits are distributed, dividends will be taxed again to the individual. This may result in higher overall effective tax rate.
  - Therefore, consider all the facts and circumstances and model out the tax impacts of the election against other planning options.

Passive Foreign Investment Companies – Definition

- Foreign corporation is a PFIC with respect to U.S. person if:
  - It is not a CFC or, if it is, the U.S. person is not a 10% shareholder; and
  - It meets income test **or** assets test (IRC section 1297)
    - Income test: 75% or more of income of taxable year is passive.
    - Assets test: At least 50% of average assets during taxable year produce or are held for production of passive income. All cash is passive!
- If a corporation is a PFIC, then unlike in the case of the CFC, no minimum percentage shareholding requirement for PFIC treatment to apply.
- Extensive attribution rules apply in determining PFIC status.

Passive Foreign Investment Companies – Definition

- PFIC status is determined shareholder by shareholder.
- For each shareholder: "Once a PFIC, always a PFIC". So even if the corporation ceases to meet PFIC income and asset tests, still a PFIC for that shareholder (whereas may not be PFIC for shareholders who buy in later).
- Big problems for shareholders of start-ups.
  - E.g., tech or medical start-up with no income for >2 taxable years except small amount of interest income.

PFICs – Consequences – 1

- When PFIC distributes income to U.S. shareholder in excess of 125% of three-year annual average level of distributions, tax on so-called "excess distribution" is increased by punitive interest charge. IRC section 1291.
- Capital gain on PFIC shares is taxed at ordinary income rates and entire gain is treated as an excess distribution.
- U.S. shareholder can elect out of these rules by making what is known as a qualified electing fund (QEF) election
  - PFIC must cooperate by providing information – often unavailable from offshore funds.
  - Effect of QEF election: U.S. shareholder required to include in his income for the taxable year his share of the "ordinary" earnings and profits of QEF for QEF's taxable year ending in shareholder's taxable year and also his share of the QEF's net capital gain.
- Alternative for publicly traded stock: Annual mark-to-market election under IRC section 1296.

PFICs – Consequences – 2

- U.S. shareholder can elect out of PFIC rules using qualified electing fund (QEF) election
  - PFIC must cooperate by providing information – often unavailable from offshore funds.
  - Effect of QEF election: U.S. shareholder required to include in his income for the taxable year his share of the "ordinary" earnings and profits of QEF for QEF's taxable year ending in shareholder's taxable year and also his share of the QEF's net capital gain.
- Publicly traded stock: Can make annual mark -to-market election under IRC section 1296.

PFICs – Planning Possibilities – 1

- **Sell offshore funds,** especially those for which a QEF election would be impossible because fund will not provide required information to U.S. holders.
- Retain funds but **make a QEF election**.
  - QEF election may be difficult or ineffective for funds organized as "fund of funds", where prospective resident has to be concerned not only with the status of the fund but also the underlying funds.
- **Exchange the funds for their U.S. equivalents**. Many funds have a parallel structure for U.S. and non-U.S. investors and will permit (or even require) a fund holder moving to the United States to exchange into the U.S. version.

PFICs – Planning Possibilities – 2

- For non-fund foreign corporations that would be PFICs because of assets or income, **consider check-the-box election**.
  - Most likely to make sense where prospective resident is minority shareholder of corporation controlled by foreign family members
  - Election causes step-up in basis of underlying assets and immediate deemed distribution of all earnings and profits, all non-taxable if effective before the residency starting date.
  - Complex structures can pose a challenge.
- Sometimes, family or partner buyout is only solution

PFICs and Trusts

- Prospective resident should be wary of the treatment of PFICs held by foreign trusts.
- IRS treats U.S. beneficiary of a trust as owner of PFIC securities owned by a trust, based on U.S. beneficiary's interest in the trust.
- U.S. beneficiary's interest may be difficult to ascertain, especially if trust is discretionary and beneficiaries are both foreign and U.S. IRS looks at actuarial interests, distribution patterns, letters of wishes. If all else fails, it requires determination of which beneficiaries would receive trust's assets upon termination.

Dealing with Existing Trusts – 1

- Trusts needs to be classified as grantor or nongrantor trusts, domestic or foreign and simple or complex.
- Grantor v. nongrantor
  - If grantor is foreign, usual definitions do not apply
  - IRC section 672(f) provides that grantor trust rules apply only if result is inclusion in income of U.S. person. Exceptions:
    - Trust is revocable – but read the details
    - Trust can only benefit grantor and/or grantor's spouse during grantor's lifetime (note possible effect of divorce if grantor's spouse has continuing interest)
    - Pooled investment trusts are treated as grantor trusts
  - If foreign grantor becomes U.S. resident or citizen:
    - Usual grantor trust rules can apply.
    - Including IRC section 679 (trust with U.S. grantor is grantor trust if any actual or potential U.S. beneficiary except trust funded >5 years pre-residence).

Dealing with Existing Trusts – 2

- Domestic v. foreign. IRC section 7701(b)(30)(E). Trust is only domestic if:
  - The trust's administration must be subject to the jurisdiction of a U.S. court ("Court Test"); **and**
  - one or more U.S. persons have the authority to control all substantial decisions of the trust ("Control Test").
- Simple v. complex
  - If trust is non-grantor trust, simple trust if all distributable net income (DNI) must be distributed each year in specified shares.
  - Otherwise, complex trust.
  - In the case of a foreign trust, capital gains are included in DNI.

Foreign v. Domestic Nongrantor Trust

	Foreign	Domestic
Estate tax	- Assets in trust are outside beneficiaries' estates (assumes there is no general power of appointment)	- Assets in trust are outside beneficiaries' estates (assumes there is no general power of appointment)
Taxation of trust – foreign income	- Trust not taxed on foreign income	- Trust taxed on worldwide income when earned or received, including CFC and PFIC income - Same rates as individuals but almost no graduated rates - Note: Distribution to beneficiaries deducted from current year income, in which case beneficiaries are taxed
Taxation of trust on U.S. income	- Investment income – 30% withholding tax (except exemption for government and corporate bonds and some other loans) - Non-real estate capital gains exempt	
Taxation of beneficiaries	- No tax until distribution received - Tax on distribution of current year income and gains - Tax on distribution of accumulated year income plus interest charge - Accumulated income all ordinary (even if original income was capital gain to trust - Interest charge on distribution of accumulated income	- Tax on distribution of current year income and gains (in which case trust is not taxed) - No tax on distribution of accumulated income
Other issues for beneficiaries	- Beneficiaries taxed on personal use of trust property (e.g., houses, planes, boats, artwork) - Beneficiaries taxed directly on CFCs and PFICs (see slide 15) so no benefit to holding such foreign corps via trust	- Beneficiaries not taxed on personal use of trust property (e.g., houses, planes, boats, artwork)

Classification of Trusts

If foreign grantor and U.S. beneficiary, grantor trust treatment only if trust revocable or grantor and beneficiary are husband and wife

Grantor is taxpayer

Grantor

Foreign

Domestic

Simple

Simple

Ordinary

Immediate

Deferred

Complex

Beneficiary is taxpayer

Beneficiary is taxpayer

Trust is taxpayer

Interest charge on deferred distributions

Dealing with Existing Trusts – 3

- Grantor trust: The grantor, including foreign trust meeting requirements of section 672(f), is sole taxpayer.
  - Trust is not subject to income tax nor are the beneficiaries, even U.S. beneficiaries. Rev. Rul. 69-70, 1969-1 C.B. 182.
- Nongrantor trust: A foreign nongrantor trust has, in summary, the following U.S. tax consequences:
  - Trust is treated as a nonresident alien
    - Therefore, it is taxed on U.S. business income and U.S. source investment income. Otherwise, it is not taxable.
  - Grantor is not taxable (as grantor).
  - U.S. beneficiaries are taxable on distributions:
    - Current income first, up to trust DNI (including capital gains)
    - Then undistributed net income (UNI), including (probably) income earned prior to U.S. residence of beneficiary. Interest charge on UNI distributions but not on UNI from pre-residence year.
- Foreign trusts involve reporting requirements with very heavy penalties. IRS Forms 3520 and 3520-A.

Dealing with Existing Trusts – 4

- Two keys: Restructure and educate.
- Restructuring:
  - Goal no. 1 is to keep trust assets out of U.S. estate tax net
    - Easy if foreign nongrantor trust established by parent or other relative who is not coming to the United States – but still need to watch out for general powers of appointment.
    - Harder if trust was established by prospective resident, especially if he or she is also a beneficiary.
  - Goal no. 2, determine if trust should domesticate. Often a good idea, but harder if trust has continuing non-U.S. beneficiaries.
  - Goal no. 3, accelerate and then clear out undistributed income.

Dealing with Existing Trusts – 5

- Educate:
  - Heavy IRS penalties heavily enforced for compliance failures.
  - Distributions are taxable! Not gifts if trust is nongrantor trust.
  - Loans of trust cash and marketable securities and use value of foreign trust assets are taxable. IRC section 643(i).
  - Indirect distributions are taxable.

Make Gifts and Create Trusts for Spouse and Children

- Consider making pre-residence gifts and creating trusts for benefit of spouse and children (and other family members)
  - Foreign person: Not subject to gift tax except if asset is U.S.-situs tangible property
  - Once U.S. resident (domiciliary): Taxable on worldwide gifts, although eligible for unified credit.
  - Don't give up control of assets needed to maintain standard of living.

Temporary Residence

- Is individual coming forever? Often, not certain.
- If the residence is temporary, or at least not necessarily permanent:
  - Delay getting a green card as long as possible.
  - Note: Dependents can only acquire green cards before 23, and can get timed out due to processing delays.
  - The reason: Punitive expatriation rules of IRC sections 877A and 2801 kick in for those giving up green card after holding such status in 8 of preceding 15 years.
- Also, consider parking assets so that gains can be realized after departure.
- Bear in mind rules relating to temporary absence (3 years of less) followed by return to United States. IRC section 877(d).

Home Country Considerations

- Overlaying every planning idea in this presentation is the potential impact on steps taken by the prospective resident, as well as his or her family, companies, and trustees in the country from which the prospective resident is moving.
- Often, home country advisors, trustees, and family members are possessive and reluctant to address U.S. tax complexities, even when your advice will not have an adverse effect on them.
- For these as much as any other reasons, planning for a move to the United States should begin early and often.

The Client Is Already Here

- Check residence timing – it may not be too late to take some helpful actions
  - Bear in mind differences between various forms of residence – Federal income tax, Federal gift and estate tax, state taxes, even home country taxes, how defined and when residence begins
  - Maintain home country residence under a treaty
- Retroactive check the box elections
- If there are plans to leave, don’t realize gains if there are plans to leave
- Consider the expatriation rules
- Go home and start over – yes, it can happen!

Questions?

STRANGER THINGS

with
Thomas Giordano and Michael Karlin

Appendix
Residence for Tax Purposes

Residents v. Nonresidents (Income Tax)

- Residents
  - Taxable on worldwide income, with no treaty benefits (to reduce U.S. tax)
  - Subject to tax and non-tax reporting requirements
  - Application of residence-based source rules → U.S. source income (e.g., interest, alimony, gains)
- Nonresidents
  - Taxable only on U.S. investment and business income, subject to statutory exceptions and treaty benefits
  - Typically not subject to U.S. information reporting

Residence under the Code

- Lawful permanent resident (green card) test: Individual is lawful permanent resident under the immigration laws. IRC section 7701(b)(1)(A)(i) and (6)
- Substantial presence test. IRC section 7701(b)(1)(A)(ii) and (3)(A)
  - Present in U.S. at least 31 days in current year, and
  - Sum of days present in current year + $\frac{1}{3}$ days present in preceding year + $\frac{1}{6}$ days present in 2nd preceding year is 183 days or more

Substantial Presence – Closer Connection

- If alien is not present for 183 days in the current year, can avoid residence by showing foreign tax home and closer connection to foreign country. IRS section 7701(b)(3)(B)
- Alien must establish "tax home" in foreign country under IRC section 911(d)(3), which cross-refers to IRC section 162 for determination, i.e., regular or, if more than one, principal place of business or, if no place of business, regular or principal place of abode
- Closer connection refers to personal ties
- Cannot have taken affirmative steps to become lawful permanent resident. IRC section 7701(b)(3)(C); Reg. section 301.7701(b)-2(f) and see next slide
- Timely filing requirement – discussed below

Steps to Obtain Green Card

- Filing any of the following is considered an affirmative act (non-exclusive list). Reg. section 301.7701(b)-2(f)
  - USCIS Form 1-508, Waiver of Immunities
  - USCIS Form 1-485, Application of Status as Permanent Resident
  - USCIS Form 1-130, Petition for Alien Relative (filed on alien's behalf)
  - USCIS Form 1-140, Petition for Prospective Immigrant Employee (filed on alien's behalf)
  - Labor Dept. Form ETA-750, Application for Alien Employment Certification (filed on alien's behalf)
  - State Dept. Form OF-230, Application for Immigrant Visa and Alien Registration
- NRA physically in the U.S. may apply for adjustment of status under Immigration and Nationality Act

Substantial Presence – Exceptions

- Nominal presence: So as not to penalize for brief business trips or trips to find home
  - 10 days still counted for purposes of meeting the substantial presence test. Reg. § 301.7701(b)-4(c)(1)
  - ***Caveat*** – Unless all days during visit are excludable, none may be excluded. Reg. § 301.7701(b)-4(c)(1)
    - **Example**: Flew to U.S. for 4 days in March, then again for 5 days in May, (1st through 5th) then returned June 1st to live (first day is June 1st)
    - **Example**: Flew to U.S. for 4 days in March, then for 8 days in May (1st through 8th), then returned June 1st to live, cannot exclude any days in May because May is part of a continuous stay in which the 10-day limit exceeded (only exclude 4 days in March, first day is May 1st)
- "Exempt individuals" (diplomats, students, teachers, medical necessity, the PGA exception). IRC section 7701(b)(5)
- Closer connection and foreign tax home (requires fewer than 183 days present in current year). IRC section 7701(b)(3)(B)
- Treaty tie-breaker

“Sign Me Up” – Elective Residence

- First-Year Election
  - Individual may elect to be treated as a resident for the last part of the year when s/he is a resident all of the following year. IRC section 7701(b)(1)(A)(iii) and (4)
    - Must spend a minimum of 31 consecutive days in the U.S.
    - Must be present in 75% of days from start of the 31-day period to December 31
- Joint Filers
    - One spouse resident and other spouse nonresident. IRC section 6013(g)
    - Both spouses residents at year end, one spouse became resident during year. IRC section 6013(h)

Residence under Income Tax Treaties

- U.S. & OECD Model Definition
  - A person subject to tax by reason of domicile, citizenship, residence or similar criteria. U.S. Model, Art. 4(1)
  - Some treaties require additional nexus (e.g., substantial presence, permanent home, habitual abode) for U.S. citizens or residents to be U.S. residents for treaty purposes (e.g., Finland, Germany, UK)
- Person taxed only based on source not a resident
- Recent proposals/BEPS: person subject to a "special tax regime" not a resident

Treaty Tie-Breaker Rules

- If person is U.S. resident under the Code and resident of treaty country under its domestic law, series of tests applied to determine a single residence for treaty purposes. US Model, art. 4(2)
  - Permanent home
  - Center of vital interests – closer personal and economic relations
  - Habitual abode
  - Nationality/citizenship
  - Competent authority determination
- Consistency Requirement. Reg. section 301.7701(b)-7(a)(1)

Non-Standard Treaties

- China
  - Proceeds directly to competent authority
- Australia
  - Switches habitual abode and center of vital interests
  - Does not have nationality as tie-breaker rule
- Certain older treaties (No Tie-Breaker Rules)
  - Greece (1953)
  - Pakistan (1957)
  - Trinidad and Tobago (1970)
  - Former USSR (1973)
    - Still applicable to Armenia (though Armenia does not recognize), Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan

Residents v. Nonresidents (Gift and Estate Taxes)

- Residents
  - Taxable on worldwide estate and gifts of assets no matter where located
  - Large exemption ($12.07 m in 2022; reverts to about half that in 2026)
  - Identity of donee or heir is irrelevant (except spouse)
  - Deduction allowed for debts
- Nonresidents
  - Gift tax on gifts of tangible property located in the United States
  - Estate tax on all property located in the United States
  - Minimal exemption – $60,000 (unchanged since 1966)
  - Limited deduction for debts
  - Small number of treaties may reduce or eliminate tax
- For both: Unlimited marital deduction but note need for QDOT if spouse is not a U.S. citizen (even if a resident)

Definition of Residence

- Based on the concept of domicile
- Regulations provide that a person has a U.S. domicile if physically present in the United States with no fixed intention to depart
  - Immigration status is relevant but not determinative
  - It is possible to have a green card and not be domiciled in the United States and it is possible to have non-immigrant status and yet be treated as domiciled in the United States

The above presentation is based on the completeness and accuracy of facts and assumptions stated above and of any other information provided to us. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. We are relying upon the relevant provisions of the Internal Revenue Code of 1986 as amended, the regulations thereunder, any applicable treaty, and the judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes also could have an effect on the validity of our conclusions. Unless you specifically request otherwise, we will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

In addition, it should be understood that presentations of this nature are for purposes of discussion and necessarily involve simplification and compression. Descriptions of tax law in this presentation should be the subject of additional more detailed analysis before compliance or planning is implemented in reliance thereon.