US PREIMMIGRATION TAX PLANNING -

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Summer was selected by the Daily Business Review for the esteemed 2015 "On the Rise" award, an honor that only 40 South Florida Lawyers under the age of 40 were selected to receive. In addition, Summer was recognized in the 2016 edition of Best Lawyers in America, in the field of Tax Law. She also currently serves as the Vice Chairperson of the United States Activities of Foreigners and Tax Treaties Committee.

Page

1.01 Introduction

Foreign individuals and families invest in and relocate to the United States for various personal, business, and, at times, tax-related reasons.

The relocation of an individual to the United States has significant U.S. tax implications, which may adversely affect not only the high net-worth immigrating individual but also the less wealthy, such as the working, middle-management executive temporarily relocating to the United States. Pre-immigration tax planning is therefore critical for almost every individual and family temporarily or permanently relocating to the United States.

This overview highlights the issues that should be considered by an individual relocating to the United States prior to and following relocation to the United States. A careful review of these issues is essential in order to permit the affected individual(s) to make informed decisions and timely take such actions as are necessary to minimize U.S. tax liabilities.

1.02 U.S. Tax Considerations – In General

In general, there are three principal categories of U.S. tax considerations that should be examined:

- U.S. federal income tax considerations;
- U.S. federal estate tax, gift tax, and generation-skipping transfer tax considerations; and
- State and local income (and, potentially, other) tax considerations.

Each of these categories is further discussed under separate headings below.

Effective pre-immigration tax planning requires a clear understanding of the specific facts concerning the immigrating individual involved and the anticipated plans and intentions of such individual regarding his stay in the United States. In addition, it must take into account both the U.S. tax implications as well as the tax implications under the tax laws of all applicable foreign jurisdictions involved - typically, the current residence country of the immigrating individual and the countries in which he has business or investment interests. The eventual pre-immigration tax plan adopted will have to take into account, and generally balance, the U.S. tax implications, the tax implications in the applicable foreign jurisdictions and, obviously, the lifestyle desired by the immigrating individual.

1.03 U.S. Federal Income Tax Considerations

[1] U.S. Federal Income Taxation of "Resident Aliens" and "Non-Resident Aliens" - In General

As a general rule, U.S. citizens, U.S. tax “residents” and domestic corporations, *i.e.*, corporations incorporated under the laws of any State of the United States,[1] are subject to U.S. federal income tax on their worldwide income irrespective of source. Conversely, an individual who is neither a U.S. citizen nor a U.S. resident (a “non-resident alien” or "NRA") and a foreign corporation (together, “foreign persons”) are generally subject to U.S. federal income tax only with respect to certain types of U.S.-source "FDAP" income (fixed or determinable annual or periodical income) and income that is “effectively connected with the conduct of a trade or business within the United States" (“ECI”).[2]

Foreign persons generally are subject to U.S. federal income tax on ECI at the regular graduated income tax rates, which rates are applied to the amount of the net taxable ECI realized by such foreign persons and range from 0 to 39.6 percent. Foreign persons are taxable by the United States on U.S.-source FDAP income (*e.g.*, certain interest, dividends, rents, salaries, wages, annuities, etc.) at a flat rate of 30 percent (or at a reduced flat rate whenever the provisions of an income tax treaty apply), where such tax is imposed on the gross amount of such income and collected through a withholding mechanism.[3] However, such persons generally are exempt from tax on most interest payments received from U.S. sources[4] and on most capital gains (other than those connected to U.S. real estate).[5]

The most important determinant of U.S. federal income tax liability is therefore the taxpayer’s “residence.” Accordingly, the specifics of any pre-immigration tax plan will largely depend on the following three factors:

First, *whether* the immigrating individual will be treated as a U.S. “resident” for U.S. federal income tax purposes at any time during his stay in the United States;

Second, *when* such individual’s U.S. residence period, if any, will begin; and

Third, if such individual is a U.S. resident under U.S. “internal” tax law, whether he will be entitled to claim the benefits of any applicable *income tax treaty* to eliminate or reduce the U.S. federal income tax liability.

[2] Residence

An individual who is not a U.S. citizen (an “alien”) is treated as a U.S. tax “resident” (also known as a "resident alien") during a particular taxable year, and, hence, is subject to U.S. federal income tax on a worldwide basis (unless an applicable treaty provides otherwise), if such individual (i) is a “lawful permanent resident” of the United States *at any time* during such calendar year (the “green card test”), (ii) satisfies the “substantial presence test” discussed below, or (iii) makes an election to be treated as a U.S. tax resident.[6]

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[1] *See* § 7701(a)(4). Unless otherwise noted, all section references are to the U.S. Internal Revenue Code of 1986, as amended (the “Code”), and the Treasury regulations promulgated thereunder.
[2] *See* §§ 871, 872, 881, 882.
[3] *See* §§ 1441 – 1446.
[4] *See* § 871(h).
[5] *See* § 865.
[6] *See* section 7701(b)(1)(A).

[a] The "Green Card Test"

In general, an individual is treated as a "lawful permanent resident of the United States" at any time if,

[i] the individual has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, and

[ii] that status has not been revoked (and has not been administratively or judicially determined to have been abandoned).[7]

Once an individual has been granted an alien registration receipt card (*i.e.*, a "green card") in accordance with the U.S. immigration laws, resident status is deemed to continue unless it is rescinded or administratively or judicially determined to have been abandoned.[8] For these purposes, resident status is considered to be rescinded if and when a final administrative or judicial order of exclusion or deportation is issued regarding the alien individual.[9] An administrative or judicial determination of abandonment of resident status may be initiated by the alien individual, the immigration authorities or a consular officer.[10] If such determination is initiated by the alien individual, resident status is considered to be abandoned when the individual's application for abandonment of his resident status, with the green card enclosed, is filed with the immigration authorities or a consular officer.[11] If such determination is initiated by the immigration authorities or the consular officer, an alien individual's resident status will be considered to be abandoned upon the issuance of a final administrative order of abandonment.[12]

As discussed further below, a green card holder who maintains sufficient connections with a non-U.S. country may in appropriate cases avoid U.S. residency in a particular if he or she files a so-called "treaty tie-break" election for that year pursuant to an income tax treaty between the U.S. and the person's other country of residency.

[b] The "Substantial Presence Test"

[i] In General

An individual who is not a U.S. citizen or a "green card" holder will be treated as a U.S. tax resident during a particular calendar year, and, hence, will be subject to U.S. federal income tax on a worldwide basis, if he is physically present in the United States for (i) 183 days or more during that calendar year, or (ii) at least 31 days during that calendar year *and*

[7] *See* section 7701(b)(6).
[8] *See* Treas. Reg. § 301.7701(b)-1(b)(1).
[9] *See* Treas. Reg. § 301.7701(b)-1(b)(2).
[10] *See* Treas. Reg. § 301.7701(b)-1(b)(3).
[11] *Id*.
[12] *Id*.

satisfies the "physical presence test" under the three-year look-back rule discussed below (the "substantial presence test").[13]

An alien individual will satisfy the "substantial presence test" under the three-year look-back rule if the sum of (i) the number of days of his physical presence in the United States in the current calendar year, (ii) one-third (1/3) the number of days of his physical presence in the United States in the first preceding calendar year, and (iii) one-sixth (1/6) the number of days of his physical presence in the United States in the second preceding calendar year, equals or exceeds 183 days.[14]

It should be noted that for purposes of the "substantial presence test" set forth above, an individual is treated as present in the United States on any day, or any fraction thereof, during which he is physically present in the United States (*i.e.,* if an individual is physically present in the United States even for part of a day, including days of departure and arrival, such day will be counted as one full day for purposes of the test set forth above).

For example, assume that an Italian individual relocates to the United States on September 1, 2016 and arrives in JFK Airport at 11:55 PM, and thereafter continuously stays in the United States. Assume further that such individual was present in the United States for 150 days in 2014 and 180 days in 2015. For purposes of determining such individual's status under the substantial presence test for the year 2016, each day such individual spends in the United States in 2016 will count as one day (totaling 122 days in 2016), each day spent in the United States in 2015 will count as one third of a day (totaling 50 "weighted" days in 2015), and each day spent in 2014 will count as one sixth of a day (totaling 30 "weighted" days in 2014). The total number of "weighted" days will therefore be 202 (*i.e.,* 122 + 50 + 30), and, hence, such individual will satisfy the substantial presence test for the taxable year 2016 and will be treated as a U.S. resident for all, or portion of, the year 2016.[15]

[ii] Excluded Days

For purposes of determining whether a foreign individual satisfies the "substantial presence test", a foreign individual will *not* be treated as present in the United States on any day, even though physically present in the United States, if such individual is (i) an "exempt individual" for such day, or (ii) unable to leave the United States on such day because of a medical condition which *arose* while such individual was present in the United States.

- Exempt Individual

An individual is an "exempt individual" for any day if, for such day, such individual is

  - a foreign government-related individual,
  - a teacher or trainee,

[13] *See* § 7701(b)(3)(A).
[14] *See* § 7701(b)(3)(A)(ii).
[15] *See* the discussion in Section 1.03[2][c] below regarding "Residency Starting Date."

- a student, or

- a professional athlete who is temporarily in the United States to compete in a charitable sports event satisfying certain requirements.

a. Government Official

A "foreign government-related individual" means any individual who is temporarily present in the United States by reason of (i) diplomatic status, or a visa representing full-time diplomatic or consular status (generally a holder of an A-visa), (ii) being a full-time employee of an international organization (generally a holder of a G-visa, such as a World Bank or IMF employee), or (iii) being a member of the immediate family of an individual described in any of the foregoing subsections.

b. Teacher or Trainee

A "teacher or trainee" means any individual (i) who is temporarily present in the United States under a "J" or "Q" visa (other than as a student), and (ii) who substantially complies with the requirements for being so present (meaning, in general, that such individual does not engage in prohibited activities that can cause the loss of his visa status).[16]

An individual will not be treated as an "exempt individual" by reason of the teacher and trainee exception for the applicable year if he has been exempt as a teacher, trainee or student for any part of any two of the six calendar years preceding such applicable year.[17] In the case of an individual all of whose compensation is described in section 872(b)(3), and who receives such compensation in each of such exemption years, the preceding limitation is applied by substituting four calendar years for two calendar years.[18]

c. Student

A "student" is any individual (i) who is temporarily present in the United States under an F or M visa or as a student under a J or Q visa, and (ii) who substantially complies with the requirements for being so present.[19] A student who undertakes unauthorized employment while being present in the United States under a student visa may fail the substantial compliance test.

For any calendar year following the fifth calendar year for which an individual was an exempt individual under the teacher or trainee exception or the student exception, such individual will not be treated as an exempt individual by reason of the student exception unless he establishes to the satisfaction of the Secretary that he does not intend to

[16] *See* Treas. Reg. § 301.7701(b)-3(b)(6).
[17] *See* Treas. Reg. § 301.7701(b)-3(b)(7)(i).
[18] *See* Treas. Reg. §301.7701(b)-3(b)(7)(ii).
[19] *See* § 7701(b)(5)(D).

permanently reside in the United States and that he substantially complies with the requirements of his visa.

Accordingly, although for certain high-net-worth individuals the student exception may offer a practical, although intellectually demanding, escape of U.S. resident status, this planning is limited in time and cannot be used indefinitely.

d. Professional Athlete

A professional athlete may exclude days of presence in the United States if he is temporarily present in the United States to compete in a charitable sports event for which all the net proceeds are contributed to an organization described in section 503(c)(3) and exempt from tax under section 501(a) and for which substantially all work is performed by volunteers.[20] This exception is, however, relatively narrow, as it covers only days on which the athlete actually competes in the sports event.

- Medical Condition

An individual is not considered present in the United States on any day if he *intends* to, but is *unable* to, leave the United States on such day because of a medical condition that *arose* while he was present in the United States.[21]

Accordingly, an individual who seeks treatment in the United States regarding an existing medical condition will not be entitled to exclude his days of presence in the United States based on the medical exception.

In addition, once the individual is able to leave the United States, the medical condition exception is extended to exclude additional days of presence in the United States only to the extent that such individual stays for a reasonable period necessary for making departure arrangements.[22]

Finally, since in order to qualify for the exception the individual must intend to leave the United States on such date, days during which the individual originally intended to be present in the United States, before the medical condition arose, are *not* governed by the medical condition exception and will be taken into account for purposes of the substantial presence test.[23]

- Days in Transit

[20] *See* Treas. Reg. § 301.7701(b)-3(b)(5).
[21] *See* Treas. Reg. § 301.7701(b)-3(c)(1).
[22] *See* Treas. Reg. § 301.7701(b)-3(c)(1).
[23] *See* Treas. Reg. § 301.7701(b)-3(c)(4), example 2.

If an individual, who is in transit between two points *outside* the United States, is physically present in the United States for less than 24 hours, such individual is not treated as present in the United States on any day during such transit.

An individual is considered to be in transit only if, while in the United States, he pursues activities that are substantially related to completing his travel to a foreign point of destination, such as waiting for a connection flight in a U.S. airport. An individual attending a business meeting or a social event while being present in the U.S. for less than 24 hours will not be entitled to exclude such days of presence.[24]

- Reporting Requirements

In order to avoid U.S. resident status, a foreign individual who wishes to rely on the exceptions regarding exempt individuals and individuals with medical conditions must file, on or before the due date of the applicable U.S. federal income tax return, IRS Form 8843 (Statement for Exempt Individuals and Individuals With a Medical Condition), and set forth the information required to support the applicable exemption.[25]

[iii] The "Closer Connection" Exception

A foreign individual will not be treated as meeting the substantial presence test with respect to a particular taxable year if such individual (i) is present in the United States on *fewer than 183 days* during such year, and (ii) establishes that, for such year, he has a *"tax home"* in a foreign country *and* has a closer connection *to such foreign country* than to the United States, provided however, that he, at no time during such year, (i) has an application for adjustment of status pending, or (ii) takes other steps to apply for status as a lawful permanent resident of the United States.[26] This statutory exception is therefore available only to persons who do not hold a green card and who spend less then half of the year in the U.S. Where available, this exception is a valuable means of avoiding U.S. residency in a particular tax year.

- "Tax Home"

For this purpose, an individual's "tax home" is the country in which his principal permanent place of business is located, or, in the absence of such regular or principal place of business, his regular place of abode. If the individual has neither a permanent place of business nor a permanent place of abode, his tax home is the country where he works.

In order to claim the closer connection exception, the individual's tax home must be located in the same jurisdiction to which he has closer connection and such tax home must be in existence for the entire taxable year.[27]

- "Closer Connection"

[24] *See* Treas. Reg. § 301.7701(b)-3(d).
[25] *See* Treas. Reg. § 301.7701(b)-8.
[26] *See* § 7701(b)(3)(B), (C).
[27]*See* IRS Publication 519, page 7.

A foreign individual will be considered as having a closer connection to a foreign country if he can establish that he maintained more significant contacts with the foreign country than with the United States.

For purposes of this determination, the relevant facts and circumstances that will be taken into account include, but are not limited to:[28]

- The country of residence designated by the individual on forms and documents;
- The location of the individual's home;
- The location of the individual's family;
- The location of the individual's personal belongings, such as cars, furniture, clothing and jewelry;
- The location of the social, political, cultural or religious organizations with which the individual is associated;
- The location where the individual conducts business activities (other than those that constitute the individual's tax home);
- The jurisdiction(s) in which the individual holds a driver's license; and
- The jurisdiction in which the individual votes.

If a foreign individual relocates during the year, he may demonstrate that he has closer connections to two foreign countries (but not more than two) during such year if he (i) maintained a tax home beginning on the first day of the year in one foreign country; (ii) changed his tax home during the year to a second foreign country, (iii) continued to maintain his tax home in the second foreign country for the rest of the year, (iv) had a closer connection to each foreign country than to the United States for the period during which he maintained a tax home in that foreign country, and (v) he is subject to tax as a resident under the tax laws of either foreign country for the entire year or subject to tax as a resident in both foreign countries for the period during which he maintained a tax home in each foreign country. [29]

A foreign individual who wishes to avoid U.S. resident status based on the closer connection exception must attach a completed IRS Form 8840 to his U.S. federal income tax return for the applicable taxable year, or, if no such return is required to be filed, file such form with the U.S. Internal Revenue Service ("IRS") by the due date for filing IRS Form 1040NR.[30]

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[28] *See* IRS Publication 519, pages 7-8.
[29] *See* Treas. Reg. § 301-7701(b)-2(e).
[30] *See* Treas. Reg. § 301-7701(b)-2(g); IRS Publication 519, page 8.

The Form 8840 generally must be timely filed, or else the exception may not apply and it may not be possible to claim the exception for that year. However, the instructions to the Form 8840 provide that, "[y]ou will not be penalized if you can show by clear and convincing evidence that you took reasonable actions to become aware of the filing requirements and significant steps to comply with those requirements."

[c] Residency Starting Date

[i] General Rule

In general, the U.S. “residence” of a foreign individual, who satisfies the substantial presence test and/or the green card test for the first time, commences on the “residency starting date”.

The residency starting date of a foreign individual satisfying the green card test, but not the substantial presence test, is the first day in the calendar year on which such individual is present in the United States as a lawful permanent resident. The residency starting date of an individual who satisfies the substantial presence test is the first day during the calendar year on which the individual is present in the United States. If the individual satisfies both the green card test and the substantial presence test, his residency starting date is the earlier of the applicable dates set forth above.

[ii] De Minimis Exception

For purposes of determining the “residency starting date” of a foreign individual such individual is not treated as present in the United States during any period or periods, not exceeding in the aggregate 10 days, for which he establishes that he has a tax home in a foreign country and a closer connection to such foreign country than to the United States.[31] It should be noted in this regard, that this exclusion applies only for purposes of determining the residency starting date of a resident individual, and it does not apply for purposes of determining whether the substantial presence test is satisfied.

For purposes of this de minimis exception, the excluded days of presence in the United States need not be consecutive, but may not exceed in the aggregate 10 days. None of the days in a continuous period of more than 10 days may be excluded.

[iii]The No Lapse Rules

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 (regardless of whether the individual has a closer connection to a foreign country than the United States during the current year) will be taxable as a resident through the end of the

[31] *See* § 7701(b)(2)(C).

current year. For these purposes, it is immaterial whether an individual is considered to be a resident under the substantial presence test or the green card test.[32]

These no lapse rules are intended to deny foreign individuals the ability to circumvent the U.S. tax rules by managing their U.S. residence periods.

[d] Elective Residence

A foreign individual who satisfies neither the substantial presence test nor the green card test for the current calendar year (the "election year") can nevertheless elect to be treated as a U.S. resident for such current year if he (i) was not a U.S. resident in the calendar year immediately preceding the election year, (ii) is a U.S. resident in the calendar year immediately following the election year, and (iii) is present in the United States for a period of at least 31 consecutive days in the election year and present in the United States during the period beginning with the first day of such 31-day period and ending with the last day of the election year (the "testing period") for a number of days equal to or exceeding 75 percent of the number of days in the testing period.[33]

If such individual makes such an election, his U.S. residence commences on the first day of the earliest such 31-day period with respect to which the 75 percent test is satisfied.

Finally, under certain circumstances, a married foreign individual, who is treated as a nonresident alien or as a U.S. resident for only a portion of the current year, might be able to elect, together with his U.S. resident or citizen spouse, to be treated as a U.S. resident for the entire year. *See* sections 6013(g) and (h).

These elections might be beneficial in certain circumstances, for example, if the foreign individual recognizes significant capital or other losses during a period in which he would otherwise be treated as a nonresident alien.

[e] Relief Under Income Tax Treaties

[i] In General

In general, 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 United States 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 particular, income tax treaties to which the United States is a party generally contain a "tie-breaker" provision under which a dual resident individual is classified as a resident of one, and only one, country in a given tax year for purposes of the income tax treaty. In general, under a typical tie-breaker provision, exclusive residence is determined by applying the following tests in the following order:

[32] *See* Treas. Reg. § 301.7701(b)-4(e). *See also* the anti-avoidance rule in § 7701(b)(10).
[33] *See* § 7701(b)(4).

- First, the individual is deemed to be a resident of the treaty country in which he has a permanent home available to him; if he has a permanent home available to him 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);

- Second, if the country in which he has his center of vital interests cannot be determined, or if he does not have a permanent home in either country, he is deemed to be a resident of the country in which he has an habitual abode;

- Third, if he has an habitual abode in both treaty countries or in neither country, he is deemed to be a resident of the country of which he is a national; and

- Fourth, 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.[34]

A foreign individual who is treated as a U.S. resident under section 7701(b) but who, nevertheless, is treated under an applicable income tax treaty as a resident of such foreign treaty country will generally be subject to U.S. federal income tax as a nonresident alien (for the period during which he qualifies as a dual resident provided that he claims the treaty benefits).[35]

An immigrating individual may therefore rely on a tie-breaker rule of an applicable treaty to avoid the imposition of U.S. federal income tax on a worldwide basis, if he can establish that he continues to be a resident of a foreign treaty country pursuant to such country's internal tax law, during all or part of his period of stay in the United States, and is allocated to that country under the relevant tie-breaker rule.

Note that despite making such a treaty tie-break election to be *taxable* as a nonresident for a particular tax year, an individual will continue to be treated as a U.S. resident for many purposes of U.S. tax law, including for purposes of certain provisions of the U.S. controlled foreign corporation rules as well as for certain reporting and compliance purposes.

[ii] Reporting

An immigrating individual who wishes to claim treaty benefits and thereby be taxed as a nonresident alien must properly and timely file IRS Form 1040NR and attach to it IRS Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)).

[3] U.S. Federal Income Taxation of Trusts, Grantors and Beneficiaries

[a] Trusts – In General

[34] *See, e.g.,* United States Model Income Tax Convention (November 15, 2006), Article 4.3.
[35] *See* Treas. Reg. § 301.7701(b)-7(a)(1).

U.S. federal income tax rules classify trusts as "foreign trusts" or "domestic trusts," and as "grantor trusts" or "nongrantor trusts." A "domestic" nongrantor trust is generally subject to U.S. federal income tax in the same manner as a U.S. citizen or resident,[36] that is, the trust is taxed on its worldwide income, subject to a deduction for distributions of the trust's "distributable net income" ("DNI").[37] A "foreign" nongrantor trust is generally subject to U.S. federal income tax in the same manner as a nonresident alien, that is, the trust is taxed only on ECI and certain types of U.S.-source income. U.S. citizens and residents who receive distributions from income of a nongrantor trust will generally be subject to U.S. federal income tax on such amounts.[38] U.S. persons who receive distributions of accumulated income and gains from a foreign nongrantor trust may also be subject to an additional tax, known as the "throwback tax," and an interest charge.[39]

[b] Domestic and Foreign Trusts

Sections 7701(a)(30) and (31) contain a two-part test for determining whether a trust will be classified as "domestic" or "foreign" for U.S. federal tax purposes. A trust that satisfies *both* tests is a domestic (or U.S.) trust; a trust that fails one or both tests is a foreign trust. A trust satisfies the first test, referred to as the *court test*, if "a court within the United States is able to exercise primary supervision over the administration of the trust."[40] A court is able to exercise "primary supervision" over a trust if that court has or would have the authority under applicable law to render orders or judgments resolving *substantially all* issues regarding the administration of the entire trust. A trust satisfies the second test, referred to as the *control test*, if "one or more United States persons have the authority to control all substantial decisions of the trust."[41]

[c] Grantor Trusts

A "grantor trust," whether domestic or foreign, is generally not treated as a separate taxable entity for U.S. federal tax purposes.[42] Instead the settlor/grantor of the trust is treated as directly owning all of the trust's assets, and the U.S. federal income taxation of income earned by the trust is determined by reference to the tax status of the settlor/grantor.[43] In either case, distributions from a grantor trust to beneficiaries other than the grantor are generally treated as gifts, which are not subject to U.S. federal income tax but may be subject to certain reporting requirements.

In general, under sections 671 through 677, a trust will be treated as a grantor trust if the grantor retains certain powers over or interests in the trust, such as a power to revoke the trust

[36] *See* § 641.
[37] *See* §§ 651(a) and 661(a). *See also* § 643(a). A foreign nongrantor trust is required to compute its DNI by including foreign-source income otherwise not subject to U.S. federal income tax, U.S.-source income exempt under treaty, and capital gains.
[38] *See* §§ 652(a) and 662(a).
[39] *See* §§ 665 - 668.
[40] *See* Treas. Reg. § 301.7701-7(a)(1)(i).
[41] *See* Treas. Reg. § 301.7701-7(a)(1)(ii).
[42] *See, e.g.*, Rev. Rul. 85-13, 1985-1 C.B. 184, Rev. Rul. 87-61, 1987-2 C.B. 219, Rev. Rul. 2007-13, 2007-11 I.R.B. 684 (situation 1). *See also* Rev. Rul. 2004-64, 2004-2 CB 7.
[43] *See* §§ 671 - 679.

or a right to receive the trust's income. In addition, under section 678, a person other than the grantor may in some cases be treated as the owner of the trust assets if that person has the power to withdraw those assets.

In 1996, section 672(f) was amended to provide that the grantor trust rules will apply with respect to a foreign trust only to the extent that they result, directly or indirectly, in amounts being currently taken into account in computing the income of a U.S. citizen, resident or a domestic corporation. This exception to the general grantor trust rules does not apply however if (i) the power to revest absolutely in the grantor title to the trust property is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor,[44] or (ii) the only amounts distributable from such portion (whether income or corpus) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.[45] In addition, the rule does not apply to certain trusts established to pay compensation, or, under a grandfather rule, to certain trusts in existence as of September 19, 1995 that are treated as owned by the grantor or another person under section 676 or 677.[46] None of these exceptions will apply to the extent a U.S. beneficiary of the trust has made direct or indirect transfers to the foreign settlor. In such a case, the U.S. beneficiary is treated as the owner of the trust for U.S. federal income tax purposes to the extent of such transfers.[47]

A U.S. beneficiary who receives distributions from a foreign grantor trust is not subject to U.S. federal income tax on such amounts;[48] however, for distributions received after August 20, 1996 the beneficiary must report the distribution to the IRS on Form 3520 and obtain a "Foreign Grantor Trust Beneficiary Statement" in order to qualify for such favorable tax treatment.[49]

Finally, section 679, as amended in 1996, currently provides that a U.S. person who directly or indirectly transfers property to a foreign trust will be treated as the owner for his taxable year of the portion of such trust attributable to such property if there is a U.S. beneficiary of any portion of such trust for such year. For this purpose, if a nonresident alien has a residency starting date within five years after the date he transferred property to a foreign trust, such individual is treated as transferring the property on the residency starting date.[50]

[d] Reporting By U.S. Beneficiaries of Distributions from Foreign Trusts

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[44] A related or subordinate person is any nonadverse party who falls within the following list of persons: (i) the grantor's spouse, if living with the grantor, (ii) the grantor's father, mother, issue, brother or sister, (iii) an employee of the grantor, (iv) a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control, or (v) a subordinate employee of a corporation in which the grantor is an executive. *See* § 672(c).
[45] *See* § 672(f)(2)(A).
[46] *See* § 672(f)(2)(B); Treas. Reg. § 1.672(f)-3(a)(3), (b)(3).
[47] *See* § 672(f)(5).
[48] Rev. Rul. 69-70, 1969-1 C.B. 182.
[49] § 6048(c); *See also* Notice 97-34, 1997-1 C.B. 422.
[50] *See* § 679(a)(4).

A U.S. person who receives during any taxable year, directly or indirectly, any distribution from a foreign trust (whether from a grantor or a nongrantor trust) must file Form 3520 with the IRS to report the name of the trust, the amount of distributions received from the trust and a calculation of the tax treatment of the distributions.[51] Form 3520 is due on the date that the beneficiary's income tax return is due, including extensions.

Form 3520 asks the U.S. beneficiary whether he or she received a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement from the foreign trust with respect to the distributions received by the beneficiary in that taxable year. The required contents of these Statements are described in the instructions to Form 3520. Each Statement requires the foreign trust to disclose certain information about its activities and whether it has appointed a U.S. agent to respond to any requests by the IRS for further information regarding the trust.

A U.S. beneficiary who fails to report to the IRS distributions received from a foreign trust will be subject to a penalty equal to 35% of the unreported distributions received. Additional penalties may be imposed for continuing noncompliance; however, the total penalties may not exceed the reportable amount. The IRS may waive any penalty if the failure to file was due to reasonable cause and not willful neglect.[52] The IRS has expressly stated that "reasonable cause" does not include refusal on the part of a foreign trustee to provide information.[53]

1.04 Pre-Immigration Income Tax Planning

[1] Avoiding U.S. Residence Status

A foreign individual that temporarily relocates to the United States might be able to avoid U.S. resident status for all or part of his period of stay in the United States by either relying on (i) the exceptions for “exempt individuals,”[54] (ii) a treaty tie-breaker,[55] or (iii) the closer connection exception.[56] If it is possible to qualify for such an exception, this is the path that should almost always be followed. Such an individual may thus have the option to relocate to the United States for a significant, although limited, period of time without being treated as a U.S. tax resident for such period of time and being subject to the many tax consequences that accompany such classification.

Furthermore, even where resident status is eventually inevitable, such individual, through careful planning, may avoid resident status during the portion of the calendar year commencing immediately following his immigration to the United States (the “grace period”). For example, an individual that has never been to the United States and relocates to the United States (without a green card) on July 15, 2016 will not be treated as a U.S. resident for 2016. Depending on the tax implications in her original country of residence,

[51] *See* § 6048(c).
[52] *See* § 6677.
[53] Notice 97-34, 1997-1 C.B. 422.
[54] *See* the discussion in Section 1.03[2][b][ii] above.
[55] *See* the discussion in Section 1.03[2][e] above.
[56] *See* the discussion in Section 1.03[2][b][iii] above.

such an individual may be able to recognize significant income during that grace period - for example, capital gains and non-U.S. source income - which may escape income taxation both in the United States and in her home country.

[2] Income Recognition and Acceleration

Individuals generally compute their taxable income based on the cash method of accounting for U.S. purposes, which generally requires the recognition of income upon the actual or constructive receipt thereof.[57] Consequently, for example, income for services performed by a foreign individual prior to her relocation to the United States that is received while she is a U.S. resident will generally be subject to U.S. federal income tax once received by the individual.[58]

An immigrating individual should therefore consider accelerating, to the extent feasible and taking into consideration foreign income tax implications, the receipt of *non-U.S.-source* income so as to cause the recognition of such income during her non-U.S. residence period, such as actually receiving payment for services performed outside of the United States or for foreign-source rents and royalties (*but see* section 467).

[3] Gain Recognition and Loss Deferral

In general, the adjusted basis of the assets of a foreign individual immigrating to the United States is not adjusted (*i.e.,* "stepped up" or "down') upon his becoming a U.S. resident. This is a critical and fundamental focus in the field of U.S. preimmigration tax planning. Given the lack of automatic basis adjustment, a subsequent taxable disposition of assets by such an immigrating individual will generally be taxable for U.S. purposes. Such U.S. federal income tax will apply to *all* of the gain (or loss) realized upon such a disposition, including the portion of the gain (or loss) accumulated during the individual's pre-immigration period.

A foreign individual should therefore consider either (i) disposing of his appreciated assets in taxable transactions to unrelated or related persons, or (ii) otherwise causing the recognition of any gain accrued with respect to such appreciated assets prior to the beginning of his U.S. residence period.[59] Equivalently, the individual should avoid the recognition of losses with respect to depreciated assets until U.S. residency has been obtained, because he should generally be able to recognize such built-in losses during his residency period.

In addition to the obvious option of disposing of appreciated assets to unrelated parties, a foreign individual may employ various techniques to recognize his gain on appreciated assets without releasing complete control over such assets.

[a] Actual or Deemed Liquidation of a Foreign Holding Company

[57] § 451(a).

[58] *See* Treas. Reg. § 1.871-13(b) and (e). *But see, e.g.,* United States Model Income Tax Convention (November 15, 2006), Article 14.

[59] It should be verified however that such individual will not be subject to U.S. federal income tax with respect to any gain recognized with respect to such appreciated assets pursuant to § 871(a)(2).

A foreign individual can cause the taxable liquidation of a foreign holding company in which he owns shares, provided that such foreign holding company is treated as a corporation for U.S. federal income tax purposes.[60] As a result of such liquidation, the holding company will be treated as selling its assets (*i.e.*, the shares of its subsidiaries) in a taxable transaction[61] and the foreign individual will be treated as disposing of the shares of such holding company in a taxable transaction.[62]

If the foreign individual receives (or is deemed to receive) the liquidation proceeds, *i.e.*, his share of the subsidiaries' shares, while still being a nonresident alien, he should not be subject to U.S. federal income tax with respect to such gain, except in unusual circumstances.[63] Similarly, the liquidating or deemed liquidating foreign holding corporation should generally not be subject to U.S. federal income tax.[64] Nevertheless, since U.S. tax principles determine the adjusted basis of a foreign person in its assets, as a result of such liquidation, such foreign individual's adjusted basis in the shares of the subsidiaries should be the *fair market value* of such shares at the time of the liquidation.[65]

An actual liquidation of a foreign company may have, however, significant corporate and securities law ramifications as well as adverse tax consequences in the foreign individual's country of residence,[66] the jurisdiction in which such holding company is incorporated and, at times, the jurisdictions where the subsidiaries are incorporated.[67]

Accordingly, as an alternative to a formal liquidation of a holding company, a foreign individual should consider effecting a deemed liquidation by either (i) electing to change the classification of a foreign holding company that is an "eligible entity" to a partnership or a disregarded entity, as applicable, or (ii) converting such holding company into another type of entity that will be treated as a flow-through entity either by reason of an election or under the default classification rules.[68]

If an entity classified as a corporation for U.S. tax purposes elects to instead be classified as a partnership, a deemed liquidation takes place, in which the corporation is treated as

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[60] *See* Treas. Reg. §§ 301.7701-1, -2, -3, - 4.
[61] *See* § 336. This assumes that such holding company does not have a corporate shareholder that holds at least 80 percent of the shares thereof.
[62] *See* § 331.
[63] If such foreign holding company holds interests in entities that are not treated as corporations for U.S. tax purposes or in other direct assets or businesses, the foreign individual will be currently taxed on the income generated by such flow-through entities (and if any U.S. trade or business is held directly or indirectly by the foreign holding company, the foreign holding company might be subject to U.S. federal income tax upon its liquidation). Thus, prior to the liquidation of the foreign holding company, it should be determined whether to "convert" such entities into corporations for U.S. federal income tax purposes (either by changing the form thereof or by making an entity classification election). *See also* §§ 871(a)(2) and 897.
[64] If, however, the foreign holding company holds directly or indirectly any interests in U.S. realty, the FIRPTA implications under § 897 must be considered.
[65] *See, e.g.*, *Biddle v. Commissioner*, 302 U.S. 573 (1938); *Gutwirth v. Commissioner*, 40 T.C. 666 (1960).
[66] It is therefore generally advisable to effect such liquidation following the departure of such foreign individual from his former country of residence and prior to the beginning of his U.S. residence period.
[67] Certain countries impose income tax on gains realized upon the transfer of shares of entities formed under their laws, even where the seller is not a resident of the applicable country.
[68] *See* Treas. Reg. §§ 301.7701-2, -3.

distributing all its assets and liabilities pro rata to its shareholders in liquidation, and immediately thereafter, the shareholders are deemed to contribute all the distributed assets and liabilities to a new partnership.[69] This causes the corporation and the shareholders to recognize any existing gain on the deemed distribution under the general rules applicable to corporate liquidations.[70] (Note that the deemed liquidation is deemed to occur immediately before the close of the day immediately prior to the effective date of the election.)[71]

A synthetic liquidation of a foreign holding company is generally preferable to a formal liquidation as the former generally does not have tax implications in foreign jurisdictions. Nevertheless, at times, such election is not feasible due to its effect on other shareholders or because the entity involved is a "per se corporation." (This latter issue can sometimes be resolved by converting the per se corporation into an "eligible entity" under local law.)[72]

Such an election is made by filing a Form 8832, and will be effective on the date specified on such form.[73] A copy of the election must be attached to the U.S. federal income tax return of the entity, or, if the entity is not required to file a return, the direct or indirect owners of the entity, for the year in which the election is effective. The election is not voided, however, solely by reason of a failure to so attach the election to a tax return. If the election specifies an effective date that is prior to the date on which it is filed, such election must be signed by each person who was a member of the entity at any time on or after the effective date of the election and is not a member on the date it is filed.[74] In addition, the election must also be signed by each person that was a member of the entity on the date the deemed liquidation occurs (*i.e.,* the day before the effective date of the election) and who is not a member of such entity on the date the election is filed.[75]

Finally, by electing to treat a foreign holding company as a flow-through entity an immigrating individual may obtain upon the sale of the subsidiaries the preferable reduced tax rates for capital gains, which ordinarily would not be applicable if the subsidiaries were sold by a foreign holding company treated as a corporation for U.S. federal income tax purposes.

[b] Actual or Deemed Liquidation of a Foreign Operating Company

In certain circumstances it might be advisable to convert a foreign eligible entity that is an operating company into a flow-through entity. In this case, the immigrating individual will be subject to U.S. federal income tax on a current basis with respect to income and gains earned by the flow-through entity. This election likely makes sense where the entity is subject to high income tax rates in its home jurisdiction, such that the immigrating individual's U.S. federal income tax liability will wholly or largely be sheltered by foreign

[69] *See* Treas. Reg. § 301.7701-3(g)(1)(ii).
[70] *See* Preamble to TD 8697 (12/17/1996).
[71] *See* Treas. Reg. § 301.7701-3(g)(3)(i).
[72] *See* Treas. Reg. §§ 301.7701-2(b)(8), -3(a), (b)(2).
[73] Treas. Reg. § 301.7701-3(c)(1). The effective date specified may not be more than 75 days before the date the election is filed or more than 12 months after such date. Treas. Reg. § 301.7701-3(c)(1)(iii). *But see* Rev. Proc. 2009-41 (permitting an election to be made retroactive up to 3 years and 75 days in certain cases).
[74] *See* Treas. Reg. § 301.7701-3(c)(2)(ii).
[75] *See* Treas. Reg. § 301.7701-3(c)(2)(iii).

tax credits. Such an election also may be advisable where the immigrating individual contemplates selling the entity and its assets are appreciated, in which case the temporary excess U.S. tax burden might be justified by the future benefit that will result from stepping up the adjusted basis of such entity's assets prior to U.S. tax residency beginning. In addition, if the entity generates significant Subpart F income in respect of which the immigrating individual will currently be subject to U.S. federal income tax at rates applicable to ordinary income, a flow-through treatment might be preferable if the foreign entity is expected to generate long-term capital gains (or be subject to significant foreign taxes, for the reasons explained above).

Note that in the case of foreign operating companies, if a company will remain a corporation for U.S. tax purposes, the immigrating individual also should consider where such foreign entities are resident for U.S. tax purposes. If the residence country is not a country with which the U.S. has an income tax treaty, any future dividends paid by such an entity generally will be taxable to the U.S. recipient shareholder at ordinary income tax rates (currently up to 43.4%). In such cases, the immigrating individual may wish to consider reorganizing or otherwise restructuring the company, if possible, so that future dividends are received from a "qualified foreign corporation" located in a treaty country and therefore eligible for long-term capital gains rates (maximum of 23.8% under current law).[76]

[c] Sale to a Related Person

A foreign individual can sell his appreciated assets to his spouse for fair market value consideration, provided that the spouse is neither a citizen nor a resident of the U.S. at the time of such sale. As a result of such a sale, the spouse should hold the assets with a fair market value basis, and the gain will generally not be subject to U.S. tax. Specifically, the general rule of non-recognition on transfers of property between spouses under Section 1041 is inapplicable where the transferee spouse is neither a citizen nor a resident of the United States.[77] Consequently, the selling spouse will recognize the gain realized on the appreciated property and the purchasing spouse will hold the assets with a fair market value basis. This alternative should be carefully implemented, only after taking into account any potential foreign tax or other implications. In addition, the applicable law concerning marital property and intra-family transfers and its application to the transferred assets and the paid consideration must be considered, and the consideration paid by the purchasing spouse should preferably be in the form of cash or other liquid assets that the purchasing spouse clearly owns and are not otherwise marital property.[78]

Alternatively, a foreign individual can formally sell his appreciated assets for fair market value consideration to a bona-fide limited partnership (or other foreign entity treated as a partnership for U.S. federal income tax purposes) formed under the laws of a tax-favored jurisdiction. The foreign individual and other members of his family may have a significant interest in such partnership.

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[76] § 1(h)(11).
[77] *See* § 1041(a).
[78] If a note is provided as consideration for the appreciated property, the note should have a relatively short maturity, should provide for market interest payable periodically and contain the other formal provisions of a true note.

In order for the form of this transaction to be respected, (i) it is advisable that the partnership purchase the appreciated property for cash obtained from an unrelated third party (such as a financial institution) or from its own existing resources (provided that such resources have not been contributed to the partnership by the selling foreign individual or any person related to him), and (ii) the partnership must be formed (and continue) for a bona-fide business purpose (and a significant interest therein should generally be held by an unrelated partner). (If the sale consideration is funded by cash contributed by the seller, the transaction (resulting in a circular flow of cash) might be recharacterized as a contribution of the appreciated assets to the partnership, in which case the desired taxable event will not occur.)

If the consideration for the sale is a promissory note, the foreign individual generally should file an election in order to avoid the application of the installment sale rules. If such rules applied to the note, future payments received after the seller has become U.S. resident would be taxable in the U.S. A nonresident alien who is not engaged in a U.S. trade or business or otherwise liable for U.S. tax is generally not required however to file a U.S. federal income tax return. In this respect, the IRS has indicated in private letter rulings that a nonresident alien will be deemed to make the election out of the installment sale rules. Since a taxpayer cannot rely on a private letter ruling issued to another taxpayer, however, it would be prudent to file a tax return and make the election.[79] Where such an election is made, it should be the case that all gain realized as a result of the sale is realized and recognized in full at the time the note is received, even though the payments on the note have not yet been made. In this way, the immigrating seller obtains a basis step-up for U.S. purposes, thereby eliminating for U.S. purposes any appreciation that accrued prior to the sale.

[d] Constructive Sale Under Section 1259

With respect to certain “appreciated financial positions,” a foreign individual may cause the recognition of gain by entering into offsetting financial transactions thereby causing a “constructive sale” of such appreciated financial positions for U.S. federal income tax purposes pursuant to section 1259. For example, if the individual owns appreciated stock, and instead of selling that stock (which the individual desires from an economic standpoint to continue to hold), the individual engages in a "short sale against the box," in which he borrows identical stock and sells that borrowed stock, Section 1259 will deem a sale of the original stock, thereby triggering off the gain for U.S. purposes. Note that any such gain should not be taxable in the U.S. assuming the seller is not yet U.S. resident.

[e] “Wash Sale” of Appreciated Positions

A nonresident alien may sell his appreciated publicly-traded stock and securities and thereafter, after a relatively short period of time and assuming market risk, repurchase similar stock and securities. This is because the so-called "wash sale rules" under Section 1091 do not apply to prevent the recognition of gains, but rather only apply to losses.

[79] *See* PLR 9412008, PLR 8708002. Although private letter rulings may not be cited as precedent in a U.S. court under section 6110(j)(3) of the Code, such rulings provide valuable indications of the IRS views on specific issues. *See, e.g.*, *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 261 n.17 (1981). Private letter rulings also constitute "substantial authority" for purposes of certain tax understatement penalty provisions of the Code. *See* Treas. Reg. § 1.6662-4(d)(3)(iii).

[4] Anti-Deferral Provisions

Prior to immigrating to the United States, an individual should carefully review the status of each non-U.S. entity whose interests he owns in order to determine the classification of each entity for U.S. federal tax purposes under the "check-the-box" regulations and the applicability of the U.S. anti-deferral tax regimes with respect to each entity.

In particular, once the classification of each entity is initially determined, it should be considered whether such classification will produce the best U.S. federal income tax consequences to the immigrating individual during his U.S. residence period. In general, a U.S. resident would prefer to conduct foreign activities that do not generate Subpart F income through a foreign entity classified as a corporation for U.S. federal tax purposes, in order to enjoy the deferral of the U.S. income tax. In certain circumstances, however, a flow-through classification would be preferable, for example, where the foreign entity is expected to generate significant losses or is subject to a high creditable income tax in a foreign jurisdiction. The immigrating individual can change the classification of any such entity either by changing the form of such entity or by making an applicable check-the-box election. (Certain type of entities, namely, "per-se" corporations, cannot elect to be treated as a flow-through entity, and, hence, if a flow-through classification is desired for such entities, the immigrating individual would be required to change the form of such entity to an "eligible entity" before making the election.)[80]

It should be noted, however, that the classification of foreign entities under the check-the-box regulations is effective not only for U.S. federal income tax purposes but also for U.S. federal estate and gift tax purposes, and, hence, the implications of such classification for U.S. federal estate and gift tax must be considered as well.[81]

In addition, with respect to foreign entities that are treated as corporations for U.S. tax purposes, the applicability of the rules under Subpart F, concerning controlled foreign corporations, and the rules applicable to "passive foreign investment companies" should be considered.

[a] Controlled Foreign Corporations

As a general rule, each "U.S. shareholder" of a foreign corporation that is treated as a "controlled foreign corporation" ("CFC") for an uninterrupted period of 30 days or more during a taxable year, who owns shares in the CFC, directly or indirectly through foreign entities, on the last day during such taxable year on which the foreign corporation is a CFC, must include in its gross income for U.S. federal income tax purposes its pro-rata share of the CFC's (i) "Subpart F income",[82] and (ii) earnings invested, or considered to be invested, in U.S. property ("section 956 Income"),[83] whether or not such income is actually distributed as a dividend.

[80] *See* Treas. Reg. § 301.7701-2(b)(8).
[81] *See* the discussion in Section 1.05 below.
[82] *See* § 951(a)(1)(A).
[83] *See* § 951(a)(1)(B).

For these purposes, a "U.S. Shareholder" is defined to be any U.S. citizen, resident or corporation or other U.S. person who owns, directly or indirectly through foreign entities, or is considered to own by application of certain constructive ownership rules,[84] 10 percent or more of the total combined voting power of all classes of stock of the foreign corporation considered for CFC status.

A foreign corporation, in turn, is treated as a CFC only if such U.S. Shareholders collectively own, or are considered to own by application of certain constructive ownership rules, *more than 50 percent* of the total combined voting power *or* total value of the corporation's stock. Any amount of income included in a U.S. shareholder's income pursuant to the CFC rules is not subject again to U.S. taxation when actually distributed by the CFC, and may entitle a U.S. corporate shareholder to an indirect foreign tax credit.[85]

As noted above, a U.S. Shareholder is required currently to include in its income for U.S. federal income tax purposes only certain portions of the earnings realized by the CFC, i.e., its pro rata share of the CFC's Subpart F income and earnings invested in U.S. property.

For purposes of the CFC rules, Subpart F income consists of three subcategories of income, namely, "Foreign Base Company Income" ("FBCI"), defined in section 954, "Subpart F insurance income" ("SFII"), defined in section 953, and certain income relating to international boycotts and other violations of public policy.[86] The Subpart F income of a CFC is limited, however, to its current earnings and profits, which may be further reduced by accumulated deficits of the CFC that were generated in prior taxable years by certain activities.[87]

It should be noted that pursuant to a "de minimis" rule, generally none of a CFC's income for a taxable year is treated as FBCI or SFII, if the sum of the CFC's gross FBCI and gross SFII is less than the lesser of 5 percent of the CFC's gross income or $1 million.[88] On the other hand, pursuant to another rule, generally referred to as the "full inclusion rule," if more than 70 percent of a CFC's gross income is comprised of "foreign base company income" and/or subpart F insurance income, generally all of the CFC's income is treated as FBCI or SFII (whichever is appropriate).[89]

Accordingly, a foreign individual should verify prior to his immigration to the United States that none of the CFCs (or entities that will become CFCs after his relocation to the United States) in which he will be a U.S. shareholder will generate Subpart F income (either by reason of the income they earn or by reason of section 956 inclusions). In case it is determined that Subpart F income might be generated by any such entity, it would be advisable to investigate whether the operation, ownership or corporate structure of the entity

[84] *See* § 958.
[85] *See* §§ 959 and 960.
[86] *See* § 952(a)(3) - (5).
[87] *See* § 952(c).
[88] *See* § 954(b)(3)(A). Moreover, pursuant to another exception, generally referred to as the "high tax exception," items of income that are subject to an effective rate of foreign income tax that is greater than 90 percent of the maximum rate of U.S. corporate tax, specified in section 11, may be excluded from a CFC's FBCI and SFII. *See* § 954(b)(4).
[89] *See* § 954(b)(3)(B).

or entities involved can be modified in order to eliminate or at least minimize the inclusion of Subpart F income.

The avoidance of current inclusion of income under Subpart F is particularly important for foreign individuals who wish to temporarily relocate to the United States, because in such a case income deferral might be all they need.

[b] PFIC Considerations

In general, a foreign corporation qualifies as a PFIC if,

[i] 75 percent or more of its gross income for the taxable year consists of passive income, or

[ii] 50 percent or more of its assets, on average, consists of assets that produce, or are held for the production of, passive income.[90]

For these purposes, the term "passive income" generally means income that satisfies the definition of "foreign personal holding company income" under the Subpart F provisions, subject to certain exceptions. It should be noted in this regard, that for purposes of determining whether a foreign corporation is a PFIC, a foreign corporation that owns, directly or indirectly, at least 25 percent of the value of the stock of another corporation, is treated as if directly owning its proportionate share of the subsidiary's assets, rather than the stock of the subsidiary, and directly earning its proportionate share of the subsidiary's income (the "subsidiary look-through rule"). In addition, interest, dividends, rents, and royalties received by the considered foreign corporation from related persons are not regarded as passive income to the extent that such amounts are allocable to income of the payor that is not passive income (the "related person look-through rule").[91]

The U.S. federal income tax treatment of a U.S. person owning, directly or indirectly,[92] stock of a PFIC is dependent on whether or not such person has appropriately elected to treat the PFIC as a "qualifying electing fund".

In particular, a U.S. person that owns stock in a PFIC may elect to treat the PFIC as a "qualified electing fund" ("QEF election"),[93] in which case he will be required to currently

[90] *See* § 1297(a). In general, the 50-percent "assets test" is applied by reference to the fair market value of the assets of the considered foreign corporation. However, a foreign corporation that also qualifies as a CFC (or any other foreign corporation that so elects) and is not publicly traded, is required to use the adjusted bases of its assets, rather than their fair market value, for purposes of determining whether the "assets test" is satisfied. *See* § 1297(f).
[91] *See* § 1297(b)(2)(C).
[92] Certain constructive ownership rules apply for purposes of determining whether a U.S. person will be treated as owning stock of a PFIC. Under these rules, a U.S. person generally is treated as owning a proportionate share of PFIC stock (i) owned by a partnership, trust or estate of which he is a partner or beneficiary, (ii) owned by a corporation of which he is a 50 percent or greater shareholder (measured by value), or (iii) owned by another PFIC of which he is a shareholder.
[93] Special rules apply, however, in cases where a U.S. shareholder makes a QEF election with respect to a PFIC after the beginning of the shareholder's holding period with respect to such PFIC (*i.e.*, where the PFIC is a nonqualified fund with respect to the shareholder for some period before the shareholder makes the election).

include in his gross income his pro rata share of the PFIC's ordinary earnings and net capital gain for the taxable year, whether or not such amounts are actually distributed as a dividend.

On the other hand, in the absence of a QEF election, a U.S. shareholder of a PFIC is subject to U.S. tax and a special interest charge at the time he receives an "excess distribution" from the PFIC or disposes of stock in the PFIC. Under this rule, income or gain recognized by a U.S. shareholder of a PFIC by virtue of an "excess distribution"[94] or a disposition of the PFIC stock, is treated as if it had been received by the U.S. shareholder ratably over the period of time he held the PFIC stock, and the tax in respect of such income or gain is generally determined by the sum of (i) the products resulting from the multiplication of each amount apportioned to a particular PFIC taxable year by the highest tax rate in effect for the corresponding taxable year (except for the amount allocated to the current year which is subject to regular tax rates), and (ii) the interest accrued on such "retrospective" tax liabilities, computed at the interest rate applicable to underpayments of tax.[95]

Accordingly, in view of the harsh rules applicable to PFICs, a foreign individual should carefully review the PFIC status of foreign entities whose interests he owns, in order to determine whether such status could be avoided, such as by restructuring the entity's operation structure or distributing certain of its assets or by converting such entity into a flow-through entity, or whether to make a QEF election or a mark-to-market election. In addition, a U.S. shareholder of a PFIC or a QEF is required to file annually together with his U.S. federal income tax return IRS Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund).

Finally, it should be noted, that under Proposed Treasury Regulations[96] a U.S. resident who ceases to be a U.S. resident is deemed to sell his PFIC shares upon the loss of his U.S. resident status. Accordingly, a foreign individual who intends to relocate temporarily to the United States may be subject to U.S. federal income tax with respect to his PFIC shares whether or not he disposed of, or received an excess distribution with respect to, such shares during his residency period.

[5] Variable Annuity and Variable Life Insurance Contracts

An immigrating individual may wish to consider allocating part of his investment assets for the purchase of either a variable life insurance policy or a variable annuity contract.

The holder of a variable contract that is compliant with U.S. tax law and respected as such is generally not required currently to include in his income the appreciation of the cash surrender value (or the value of the death or annuity benefits under the contract) until

[94] An "excess distribution" is any distribution during the current taxable year that exceeds 125 percent of the average amount of distributions received during the three preceding years (or, if shorter, the taxpayer's holding period prior to the current taxable year). No "excess distributions" can occur, however, during the first year of the U.S. shareholder's holding period.

[95] It should be noted however that a foreign corporation is not treated as a PFIC with respect to a shareholder for those days included in the shareholder's holding period when the shareholder was not a U.S. person. *See* Prop. Treas. Reg. § 1.1291-1(b)(1)(i); Treas. Reg. § 1.1291-9(j)(1).

[96] *See* Prop. Treas. Reg. § 1.1291-3(b)(2).

payments under the contract are made. The death benefit under a life insurance policy is generally exempt from U.S. federal income tax.[97] This is true regardless of whether the insured was a U.S. or foreign individual, and regardless of whether the recipient is a U.S. or foreign person.[98]

In addition, interim distributions under a life insurance contract, other than a policy that is classified as a "modified endowment contract" ("MEC") under section 7702A, first apply to reduce the policyholder's investment in the contract and loans secured by the contract are generally not treated as distributions under the contract. A holder of a non-MEC life insurance policy can therefore effectively monetize a significant portion of the cash surrender value of the policy without incurring taxable income. On the other hand, under a life insurance policy that is characterized as a MEC - generally a policy whose premiums are front-loaded, such as an upfront-single-premium policy - interim distributions are considered taxable income to the extent of the profits accumulated under the policy and loans under the policy are deemed to be distributions.[99]

Premiums paid for a life insurance policy or an annuity contract with respect to the life of a U.S. resident or citizen to a foreign insurer are subject to a 1 percent excise tax.[100] In addition, payments under a variable contract by a domestic insurer are generally treated as U.S.-source income. Accordingly, contracts issued by a U.S. insurer (or a foreign insurer that elected to be treated as a U.S. corporation under section 953(d)) might not be suitable for an immigrating individual who contemplates leaving the United States in the future, as distributions under such policy (other than upon death) might be subject to U.S. withholding tax.

A foreign individual who wishes to relocate temporarily to the United States can acquire an annuity contract, thereby achieving the deferral of income, and if the insurance company is foreign, the annuity payments will not be subject to U.S. federal income tax if the annuity starting date occurs after the end of such individual's U.S. residence period. Similarly, an individual who wishes to relocate to the United States for an indefinite period of time may, through a life insurance trust (to avoid U.S. estate tax),[101] acquire a variable life insurance contract.

There are several disadvantages, however, to variable contracts. First, in order to be "U.S. compliant" the policy must comply with certain rules, and, hence, part of the investment will be allocated to finance the mortality risk. Second, in order for the policy to be respected for U.S. federal income tax purposes, the policyholder must have limited control over the investments underlying the policy[102] and certain diversification requirements must be

[97] *See* § 101.
[98] *See* Rev. Rul. 2004-75, 2004-31 I.R.B. 109.
[99] *See* §§ 72(e)(5)(C), 72(e)(10), 7702A.
[100] *See* §§ 4371 – 4374.
[101] By reason of the potential application of § 684 and Treas. Reg. § 1.684-2(e), which might cause the recognition of gain upon the immigrating individual's departure from the United States or death, a U.S. (rather than foreign) life insurance trust is likely to be preferable.
[102] *See Christoffersen v. U.S.*, 749 F.2d 513 (8th Cir. 1984); Rev. Rul. 2003-92, 2003-33 I.R.B. 350; Rev. Rul. 81-225, 1981-2 C.B. 12.

satisfied.[103] Third, the fees charged by the insurance company in connection with this type of policy might be significant. Fourth, for a variable contract issued by a foreign insurer, there is some risk that the policy will be treated as an "original issue discount" debt instrument,[104] and hence the policy investments generally should not be heavily allocated to safe assets. Fifth, if life insurance is desired, prepayment of the premium prior to the U.S. residence period (to avoid the excise tax) may cause the policy to be treated as a MEC, thereby eliminating the flexibility to liquidate part of the contract in a tax-free manner. Sixth, an annuity contract converts what might be capital gains into ordinary income.

[6] Evaluate Trusts

If the immigrating individual or any member of his family is the grantor, trustee or beneficiary of, or has any other right with respect to or power over, any trust, the U.S. federal income and estate tax implications of such a trust must be considered.

First, the relocation of the immigrating individual and his family to the United States may cause a change in the situs (U.S. or foreign) or classification (grantor or non-grantor) of the trusts involved - for example, by reason of section 679(a)(4) (treating a foreign grantor as a U.S. grantor if he becomes a U.S. resident within 5 years after a transfer to a trust is effected) or sections 679(b) and (c)(3) (relating to U.S. beneficiaries).

Second, it should be verified that trusts of which the immigrating individual or his family are beneficiaries will not invest in undesirable investments (from a tax perspective), such as shares of PFICs.

Third, the investment strategies and patterns of distributions by the trusts might need to be modified in order to minimize U.S. tax liabilities (such as by deferring distributions to a non-U.S. residence period) and to avoid the throwback rules.

[7] Pre-Immigration Trusts

In anticipation of immigrating to the United States and becoming a U.S. resident, an immigrating individual may find it useful to establish a trust in an offshore jurisdiction to provide for the orderly transfer of beneficial interests in the trust assets during his lifetime or at his death. The use of a trust may provide more testamentary freedom and ease of administration after the death of the settlor as compared to procedures in the individual's home country or the country in which the assets are located.

Section 679(a)(4), enacted in 1996, provides, however, that a non-U.S. individual who becomes a U.S. person will generally be treated as the owner, under section 679 of the grantor trust rules, of any property which he transferred to a foreign trust within the five-year period prior to his U.S. residency starting date. Specifically, such individual will be treated as having transferred the property (together with any undistributed income, appreciation and gains thereon) to the trust on his U.S. residency starting date. This rule does not apply,

[103] *See* § 817(h); Treas. Reg. § 1.817-5.
[104] *See* § 1275(a)(1)(B)(ii).

however, if the foreign trust does not have any U.S. beneficiaries after the grantor's U.S. residency starting date.

Consequently, an immigrating individual may nevertheless find the establishment of a pre-immigration trust useful (i) where all of the trust beneficiaries are non-U.S. persons, (ii) as a mechanism to reduce U.S. estate tax exposure, or (iii) for the accomplishment of non-tax objectives.

[8] Payments by the Relocating Individual – Review Source Rules

The impact of the relocation of the immigrating individual on the source of payments he is required to make, such as interest and alimony which are sourced based on the residence of the payor, should be evaluated to ensure that no such payments will be subject to U.S. withholding tax once the individual relocates to the United States.

1.05 Minimize Exposure to U.S. Estate, Gift and Generation-Skipping Transfer Taxes

[1] In General

In general, the U.S. federal estate, gift and generation-skipping transfer taxes apply to U.S. citizens and residents on a worldwide basis, subject to a generous lifetime exclusion ($5,450,000 combined lifetime gifts and bequests for 2016). On the other hand, nonresidents who are not U.S. citizens are generally subject to these transfer taxes only with respect to transfers of property located or deemed located in the United States ("U.S.-situs assets").[105] However, under U.S. federal tax law, nonresident aliens (except for those who were U.S. citizens at any time within the ten years preceding the transaction in question- *see* Treas. Reg. section 25.2501-1(a)(3)) are subject to gift tax only on completed gifts of real or tangible personal property that is situated or deemed situated in the U.S. Nonresident aliens are not subject to federal gift tax on transfers of intangible property. Where a gift of intangibles is concerned, the situs of the intangibles is irrelevant. As such, whether a nonresident alien makes a completed gift of stock in a U.S. corporation, or stock in a foreign corporation, federal gift tax is generally not applicable to the transfer.[106]

The estate of a deceased nonresident who holds property subject to the U.S. federal estate tax is entitled to a limited charitable estate tax deduction (section 2106(a)(2)) and a limited credit of $13,000, which effectively exempts the first $60,000 of taxable property (section 2102(c)(1)). Tax is imposed on the decedent's taxable U.S. estate at the usual estate tax rates, which in 2016 reach a maximum of 40% of the value of the taxable estate.

In general, there is no longer any marital deduction for transfers made at death to a surviving spouse who is not a U.S. citizen except to the extent the property is transferred to a "Qualified Domestic Trust," or "QDOT," in a timely manner.[107] This rule applies regardless

[105] *See* §§ 2101(a) and 2103 (estate tax); §§ 2501(a) and 2511(a) (gift tax).
[106] *See* §§ 2501(a)(2) and 2511(a). If a nonresident alien makes a completed gift of an interest in a foreign entity that is treated as a partnership for U.S. tax purposes, the analysis is more complicated. In such cases, there is a risk that the foreign entity may be disregarded and the transaction viewed as though the nonresident made a transfer of a proportionate amount of the assets underlying the partnership.
[107] *See* § 2056(d).

of whether the transferor spouse is a U.S. or foreign person, and even where the non-U.S. citizen spouse is a resident alien of the United States for U.S. federal income tax purposes (as where the spouse holds a valid green card).

A QDOT is essentially a security device for ensuring that, either upon the distribution of principal from the trust during the spouse's lifetime, or at the spouse's death, the trust principal will be subject to U.S. federal estate tax as if it were included in the estate of the transferor spouse. A QDOT can be established by the transferor spouse, by the transferee spouse, or by the executor of the transferor spouse. Only property which passes from the deceased spouse to a QDOT, or which passes to the surviving spouse and is then irrevocably transferred or assigned to the QDOT in a timely manner, qualifies for the estate tax marital deduction.

[2] Residence

For U.S. federal transfer tax purposes, a "resident" is an individual who is *domiciled* in the United States. A "nonresident" is an individual who is not a U.S. citizen and who is not domiciled in the United States. In general, a person acquires a domicile in a place by living there, even for a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[108]

It is possible for an individual to be a "resident alien" of the United States for U.S. federal income tax purposes by reason of holding a green card or meeting the substantial presence test, and yet remain a nonresident/nondomiciliary of the United States for purposes of the U.S. federal estate, gift and GST taxes. Although less likely, it is also possible for an individual to be a nonresident of the United States for income tax purposes and a resident of the United States for transfer tax purposes.

[3] U.S.-Situs Assets

For purposes of U.S. federal estate tax, "U.S.-situs assets" include the following: (i) real estate located in the United States, (ii) tangible property (including cash) located in the United States, (iii) debt obligations issued by U.S. persons, except for deposits with persons "carrying on the banking business" or with certain savings institutions and certain portfolio debt obligations, (iv) stock of U.S. corporations, regardless of the location of the stock certificates, the stock transfer offices or the sources of the corporation's income,[109] and (v) certain intangible property having a U.S. connection. The application of the situs rules to interests in partnerships and other non-corporate business entities is not entirely clear.

NRAs often hold U.S. stocks or securities through a foreign holding company. Since on the death of the NRA, he owns stock in a foreign corporation (which owns U.S. stocks or securities), absent unusual circumstances, the stock of the foreign holding company will not be included in the U.S. estate of the NRA. As discussed previously (at 1.04[3][a]), it is often

[108] *See* Treas. Reg. § 20.0-1(b)(1).
[109] *See* § 2104(a); Treas. Reg. § 20.2104-1(a)(5).

advisable to elect with regard to a wholly-owned eligible entity to change its classification to a disregarded entity in order to obtain a basis step-up for income tax purposes in the assets held by the foreign holding company. This raises the somewhat open question of whether such an election will apply for estate tax purposes as well as income tax purposes. To the extent it does not, this will produce the very favorable result of a basis step-up for the U.S. stocks and bonds held by the foreign holding company without the estate tax inclusion of the holding company stock.

The Treasury regulations[110] state that elective classifications are for "federal tax purposes" but do not specify which tax. In the Pierre case[111], the Tax Court held that under the classification regulations, a single member LLC, validly formed under state law, was not required to be disregarded in determining how to value and tax a donor's transfer of an ownership interest under the federal gift tax regime. The Court also noted that "the federal estate tax is interpreted in pari materia with the federal estate tax". The Pierre case, thus, opens up the possibility that a disregarded foreign holding company will not be included in the U.S. estate of a NRA even though its assets if held directly by the NRA would be included.

[4] Estate Tax Planning

The domicile of an individual, and in particular the lack of a definite present intention of removing from a particular location, is determined based on all facts and circumstances. The following is a non-exclusive list of facts and circumstances that are generally taken into account in determining whether an individual has a U.S. domicile for U.S. federal estate tax purposes:

[a] The individual's length of stay in the United States, as compared with the period of time the individual spends in other locations.

[b] The purpose of the individual's presence in the United States, including whether that purpose *requires* the individual's presence in the United States and whether that purpose can be accomplished in a *finite* period of time.

[c] The location and pattern of use of the individual's principal residence, and whether that residence is owned or rented, as compared with any residence or residences that the individual maintains in other locations.

[d] The location of the individual's place of business or employment, and the degree of his involvement with U.S. businesses compared with businesses in other locations.

[e] The location of the individual's family connections, including where he spends time with his family and the location of schools attended by minor children.

[f] The physical location of items that have significant sentimental value to the individual, such as family heirlooms, works of art, collections of books, stamps and coins.

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[110] Treas. Reg. § 301.7701-1
[111] Pierre v. Commissioner, 133 TC 24 (2009)

[g] Whether the individual acknowledges residence in a non-U.S. jurisdiction, and the extent (if any) that he bears the burdens of such residence, such as by paying resident income taxes in that other jurisdiction.

[h] The frequency and nature of business conducted by the individual within the United States for legal, medical and other professional services in relationship to services performed at other locations.

[i] The location of the individual's investments, and whether and to what extent the supervision and management of those investments requires the individual to be present in the United States or in the other location.

[j] The location of the individual's active involvement or active membership in clubs or organizations, including whether the individual is a "resident" or "nonresident" member in that location.

[k] The address used by the individual where he is required or asked to state an address, such as for receiving bank statements, vendor bills, financial data and correspondence concerning family business, for tax returns or any other legal documents (such as a Will or a driver's license), and for non-legal purposes (such as hotel registrations).

[l] The location of any driver's or other vehicle operator's license, and the location of any automobiles, boats or airplanes owned or rented by the individual.

[m] The location of the individual's bank accounts, and the relative activity of the accounts in the United States and in the other location.

[n] The location where the individual is registered to vote and the degree to which he exercises the privilege; the location of the individual's political activity and political contributions.

[o] The location of the individual's charitable activities and charitable contributions.

[p] The location of any safe deposit boxes, and in particular any such boxes holding valuables and/or family records.

[q] The location where the individual intends to be buried, particularly if the individual owns a burial plot in that location.

[r] The location where the individual's Will is executed and probated.

An immigrating individual who relocates to the United States and wishes to maintain a non-U.S. domicile status for a limited period of time should take, or refrain from taking, such actions as necessary to minimize the risk that he or his family will be treated as U.S. domiciliaries for U.S. federal estate tax purposes.

In addition, he should minimize the holding of U.S.-situs assets, such as U.S. real property, tangible assets located in the United States and interests in U.S. entities.[112] In this regard, he should consider properly transferring all or part of his U.S.-situs assets to a foreign corporation prior to his relocation to the United States.[113] This holding structure may have, however, disadvantageous income tax consequences and should be carefully reviewed.[114]

Finally, the immigrating individual should consider acquiring, through a life insurance trust,[115] term life insurance policy (with a death benefit equal to the potential estimated U.S. estate tax liability) to protect against any U.S. estate tax exposure.

[5] U.S. Gift Tax Planning

A nonresident alien who makes a gift of U.S.-situs property subject to the U.S. federal gift tax (*i.e.*, tangible property with such a U.S. situs) is entitled to the benefit of the annual gift tax exclusion (section 2503) and to a limited charitable gift tax deduction (section 2522(b)), but not to the unified credit (section 2505) or to the "splitting" of gifts with a spouse (section 2513). U.S. federal gift tax is imposed on such individual's taxable U.S. gifts at the usual gift tax rates, which in 2016 reach a maximum of 40% of the value of the gift.

There is no marital deduction available for gifts made to a spouse who is not a U.S. citizen. However, every donor spouse, U.S. or foreign, is entitled to give up to $100,000 each year to a non-U.S. citizen spouse free of gift tax (this amount is indexed for inflation and is $148,000 for the year 2016).[116] Any such gifts must qualify as annual exclusion gifts under section 2503(b); that is, the donee spouse must receive a "present interest" in the gifted property.

Accordingly, a nonresident individual should not give to his spouse or other persons any gifts of U.S.-situs property that might be subject to U.S. gift tax. In this regard, the

[112] Where U.S. spouses own property in joint name and one spouse dies, the deceased spouse is deemed to have owned one-half of the property and the surviving spouse is deemed to own the other half, regardless of which spouse provided the funds to acquire the property. *See* § 2040(b). TAMRA repealed this rule where the surviving joint owner is not a U.S. citizen. *See* § 2056(d)(1)(B). As a result, in such cases the gross estate of the first spouse to die (whether U.S. or foreign) includes the entire value of jointly-held property, unless the executor of such spouse's estate submits facts sufficient to show that the property was not entirely acquired with consideration furnished by the decedent, or was acquired by the decedent and surviving spouse by gift, bequest, devise, or inheritance. Accordingly, where an account or other property is owned jointly with a non-U.S. citizen spouse, the spouses should keep detailed records.

[113] In general, a nonresident alien is not subject to U.S. federal estate tax with respect to stock in a non-U.S. corporation (treated as a corporation for U.S. federal tax purposes) owned by him at the time of his death, provided that such corporation is not a sham and does not act as a nominee for the benefit of the shareholders. *See* Treas. Reg. § 20.2105-1(f); *See also Fillman v. U.S.*, 355 F.2d 632 (Ct. Cl. 1966) (U.S.-situs assets held by a foreign corporation, which acted as a nominee for the benefit of its shareholder, held to be included in the taxable estate of the decedent shareholder). Accordingly, such foreign corporation will have to perform all of the functions required to maintain its bona-fide separate existence, such as keeping corporate records up to date, maintaining separate bank accounts, holding annual board of directors meetings, keeping minutes of such meetings and resolutions and properly electing directors and officers; and all of the investments and transactions in which it is involved must be done solely in the name and for the benefit thereof. *See also* §§ 2104, 2035-2038.

[114] *See* the discussion in Section 1.04[4] above.

[115] *See* the discussion in footnote 101 above.

[116] *See* § 2523(i), Rev. Proc. 2015-53.

immigrating individual should not open joint bank, securities or other financial accounts with his spouse or transfer assets to any such accounts or otherwise use assets he owns to acquire other property jointly with his spouse without first reviewing the gift tax implications of these actions.

In addition, he should consider making gifts of non-U.S.-situs assets, either directly or, under certain circumstances, through certain irrevocable trusts, prior to his relocation to the United States.

[6] Tax Treaties

The United States has entered into tax treaties that govern transfer taxes with a number of foreign countries that limit the ability of the United States to impose such taxes. For example, an immigrating individual whose domicile status under the Code is unclear may clearly be treated as a nonresident of the United States under such a treaty and therefore be exempted from U.S. transfer taxes.[117] The provisions of each such relevant treaty will have to be considered to evaluate their effect on the potential estate and gift tax exposure of the immigrating individual.

1.06 State and Local Tax Considerations

State and local income and transfer taxes can be significant. In addition, the applicable rules determining *whether* and *when* an immigrating individual will be treated as a "resident" of a particular State or locality can be completely different from the corresponding U.S. federal tax rules. (For example, subject to certain exceptions, for New York State income tax purposes an individual is considered a New York resident if he either (i) maintains a permanent place of abode in New York State and spends more than 183 days in New York State during the taxable year, even if he is not domiciled in New York, or (ii) is domiciled in New York.[118]) In addition, sales and use taxes might be imposed if an immigrating individual intends to bring into a particular State valuable tangible property, such as art.

Accordingly, a complete tax plan should not ignore the State and local tax implications of the relocation of an immigrating foreign individual into that State or locality and must consider such implications prior to the relocation of such individual to the United States.

1.07 Conclusion

As described in detail in this article, effective pre-immigration planning requires a clear understanding of the specific facts concerning the immigrating individual involved and his anticipated plans and intentions. To illustrate, the Appendix provides a series of examples reflecting typical situations encountered in pre-immigration tax planning. Each example also includes a brief planning note.

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[117] *See, e.g.*, the Estate Tax Treaty between Germany and the United States, Article 4.
[118] *See* N.Y. Tax Law, Section 605(b)(1).

As individuals and families become increasingly mobile, tax planning opportunities for well-advised taxpayers will become ever more valuable and the need for their advisors to be aware of these opportunities ever more critical.

APPENDIX

PRE-IMMIGRATION TAX PLANNING CASE STUDIES

[1] Case Study 1

Mrs. Juarez is a NRA living abroad with her U.S. citizen spouse. In 2016, she will obtain a green card and move to the U.S. Mrs. Juarez has a $5 million unrealized loss in depreciated securities that she is considering selling.

Potential planning: Mrs. Juarez should consider the U.S. tax benefits of delaying recognition of the losses from the sale of the securities until after she becomes a U.S. resident in 2016.

[2] Case Study 2

Assume the same fact pattern as Case Study 1, except that Mrs. Juarez has already recognized the $5 million of losses from the sale of securities in 2016.

Potential planning: Although Mrs. Juarez is not yet a U.S. resident for 2016, depending on Mrs. Juarez's other 2016 income and investments, it may be beneficial to make an election under Section 6013(g) for Mrs. Juarez to be treated as a U.S. resident for the year 2016 to file a joint return with her U.S. citizen spouse to establish the $5 million capital loss for U.S. tax purposes in 2016.

[3] Case Study 3

Assume the same fact pattern as Case Study 1, except that Mrs. Juarez instead has $5 million of unrealized gain in appreciated securities.

Potential planning: Depending on how Mrs. Juarez's home country taxes gains from the sale of securities, it may be beneficial to recognize the $5 million of gains in 2016, prior to becoming a U.S. resident, in order to avoid subjecting the unrealized appreciation to U.S. income tax.

[4] Case Study 4

Mr. Martinez is currently an NRA, but will become a U.S. resident under the substantial presence test in 2017. For services performed outside of the U.S., he is due $1 million of compensation income, which has not yet been paid.

Potential planning: Mr. Martinez should consider accelerating the receipt of the $1 million of income prior to becoming a U.S. resident, in order to avoid subjecting the compensation to U.S. income tax. (The effect of accelerating the income in the current country needs to be considered also).

[5] Case Study 5

Mr. Petit is a NRA and is planning to become a U.S. resident alien in the near future. Mr. Petit owns a foreign corporation, which holds several highly appreciated non-U.S. situs assets.

Potential planning: Mr. Petit may benefit from a "check-the-box" election to treat the foreign corporation as a disregarded entity or partnership. If the election is made while Mr. Petit is a NRA, the basis of the entity's assets should be stepped up to fair market value as of the date of the election without any U.S. or foreign income tax impact.

[6] Case Study 6

Assume the same fact pattern as Case Study 5, except that Mr. Petit already recently became a U.S. resident.

Potential planning: Consider whether Revenue Ruling 2009-41 may be used to do a late check-the-box election retroactive to a date prior to the residency start date.

[7] Case Study 7

Ms. Meyer is a NRA with substantial wealth. She is planning to establish domicile in New York soon to be closer to her grandchildren. Ms. Meyer intends to leave large bequests to her family.

Potential planning: Depending on the transfer tax laws of her current country of residence, prior to establishing U.S. domicile Ms. Meyer should consider gifting intangible property as well as real/tangible personal property situated outside of the U.S. in order to avoid the U.S. gift and estate tax. Note that it may be possible for Ms. Meyer also to convert certain tangible U.S. situs assets into intangible form, if relevant, prior to making any such transfers. Depending on the size of the planned transfers, Ms. Meyer may also consider making such transfers to a trust, rather than outright (note that the trust would likely be a grantor trust for U.S. income tax purposes once Ms. Meyer takes up U.S. residency; however, the trust can provide valuable transfer tax benefits to the donees and their heirs).

[8] Case Study 8

Mr. Aydin is a NRA with no intention of becoming a U.S. person. Mr. Aydin has substantial wealth held in foreign corporations, including operating companies. Mr. Aydin intends to leave his fortune to his son and grandson, who are both U.S. citizens.

Potential planning: Instead of making outright gifts to his son, which would bring the assets into the son's U.S. taxable estate, Mr. Aydin should consider planning opportunities such as gifting the foreign corporations to a revocable foreign grantor trust. The trust could continue for the life of the son and grandson. During Mr. Aydin's lifetime he will be treated as the owner of the trust assets for U.S. tax purposes. Distributions to the son or grandson during Mr. Aydin's life would not be subject to U.S. income tax (the trust would generally need to provide the recipient with a "foreign grantor trust beneficiary statement" each time a distribution is made and the receipt of the gift would need to be reported on a Form 3520 with a copy of the beneficiary statement attached). After Mr. Aydin's death, the trust would become a nongrantor trust, at which point it could pay all current income out or use other planning techniques to mitigate the throwback tax, including decanting the assets of that trust into a previously established U.S. irrevocable trust or domesticating the foreign trust into the U.S. In addition, the foreign corporations may become either CFCs or PFICs by attribution to the U.S. beneficiaries of the trust's ownership of the shares. CFC, PFIC, Section 645 elections, basis-step-up and check-the-box planning opportunities need to be considered. Section 645, in particular, may provide valuable benefits.

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