Landing Safely in Area 51 – Counseling Aliens About U.S. Taxes

Orange County Estate Planning Council

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Michael Karlin

Karlin & Peebles, LLP
8383 Wilshire Boulevard, Suite 708
Beverly Hills, CA 90211
323.852-0030 ● fax 310.388.5537
Michael J. A. Karlin – 323.852.0033 mjkarlin@karlinpeebles.com
Jane Peebles – 310.274.5245 ● jpeebles@karlinpeebles.com

So We Are Clear What This Is About

Mars Attacks! © 1996 Warner Bros.

Overview

This program looks at the tax issues confronting an alien moving to the United States, including:

- What's at stake in becoming a resident
- Residence and domicile
- Pre-immigration planning
- Post-residence issues
- Departure and pre-departure planning

What’s at Stake in Becoming a Resident

Income Tax

- U.S. citizens and residents are subject to income taxation on their worldwide income
  - Income is taxed whether or not it is remitted to the United States
  - Income must be computed using the full panoply of U.S. income tax accounting rules
  - Because third party reporting (on Forms W-2 and 1099) rarely applies where the payor is foreign, the United States requires much more comprehensive reporting by taxpayers of their foreign activities and backs this up with ferocious penalties for the non-compliant
  - Double taxation is avoided primarily by allowing U.S. persons to credit foreign taxes against U.S. income tax

Income Tax

- Nonresident aliens are taxed only on two broad categories of income:
  - Income effectively connected with the conduct of a trade or business within the United States (“ECI”)
  - Fixed or determinable annual or periodical income, e.g., interest, dividends, rents, royalties, that is not ECI (“FDAP income”) but has a U.S. source
    - Many types of interest (bank interest, “portfolio interest”) exempt
- <u>Net</u> amount of ECI taxed at regular graduated rates
- <u>Gross</u> amount of FDAP income taxed at 30%
  - Under FIRPTA, income from the disposition of U.S. real property interests is deemed to be ECI
  - Other capital gains, e.g., sales of stock, are not taxed

Withholding

- Tax on ECI generally paid by NRA
- However, withholding is required as follows:
  - Payor to independent contractor for personal services must withhold 30% *(section 1441)*
  - Payor to employee must withhold under usual domestic rules *(section 3102)*
  - Transferee of USRPI must withhold 10% of proceeds of disposition *(section 1445)*
  - Partnership must withhold on NRA's share of partnership ECI *(section 1446)*, using estimated tax computation
- Tax on FDAP income is generally collected by withholding
- Numerous exceptions under statute and treaties

Tax Treaties

- The United States is party to income tax treaties with 65+ countries. Treaties reduce double taxation:
  - Clarify what income taxes are creditable
  - Declare that taxpayers who would otherwise be residents of both countries are resident of only one of them
  - Limit taxation of business income by United States unless treaty resident has U.S. permanent establishment
  - Reduces withholding rates on interest and royalties (often to 0%) and dividends (typically 5% for corporations but 0% in some cases and typically 15% for individuals)
  - Special rules for employees, artists and athletes, teachers, students, pensions, government agencies

Estate and Gift Taxes

- NRA is taxable on gifts of U.S. situs property
- In general, property has a U.S. situs only if it is real property or tangible personal property
- Cash:
  - Notes and coins are regarded as tangible
  - Where cash is transferred by wire transfer or check, only 100% safe method is foreign-to-foreign transfer
  - Wire transfer from abroad to U.S. account is probably safe
  - Gift of cash conditioned on use by donee to purchase donor's U.S. situs property may be subject to tax
- Stock and partnership interests are intangible
  - Tax free contribution of U.S. situs property to corporation or partnership under section 351 or 721 followed by immediate gift of stock or partnership interest is risky

Becoming a Resident

Residence for Tax Purposes

- Residence means different things for purposes of different taxes and related regulatory requirements:
  - General Federal tax residence rules *(section 7701(b))*
  - Federal estate and gift tax purposes (domicile)
  - State tax purposes
  - Regulatory and reporting requirements, e.g., foreign bank account reports, money laundering rules, etc.
  - Home country taxation (and other requirements)
- These rules are not uniform and coordination is erratic
- It is critical to determine when U.S. residence (and citizenship) begins and ends

RA for Income Tax Purposes – Two Tests

- **Lawful permanent resident test** *(section 7701(b)(6))*
  - Sometimes referred to as the green card test
  - Applies to LPRs
- **Substantial presence test** (*section 7701(b)(3)*)
  - Sometimes referred to as the day counting test
  - Applies to non-immigrants

LPR Test

- Alien is resident with respect to any calendar year if he or she is an LPR at any time during such calendar year
- Definition of LPR:
  - Alien has been admitted with, or adjusted to, lawful permanent resident status with the right to reside and work without restriction in the United States, <u>and</u>
  - Status has not been revoked (and has not been administratively or judicially determined to have been abandoned) <u>and</u>
  - Alien is not tax resident of another country under the provisions of a tax treaty
- Many aliens hold green cards but live abroad – they remain tax residents so long as their LPR status has not been taken away

Substantial Presence Test

- Two possibilities:
  - Either 183 days of physical presence in current calendar year <u>*or*</u>
  - CY >= 31 days *and* $CY+(PY_1/3)+(PY_2/6)=183$, where
    - CY = days of physical presence in current calendar year
    - PY_1 = days of physical presence in preceding calendar year
    - PY_2 = days of physical presence in 2nd preceding calendar year

    unless taxpayer shows closer connection to a foreign tax home in current year (see next but one slides)
- If CY < 31, not resident under this test
- Not all days of presence are counted (see next slide)

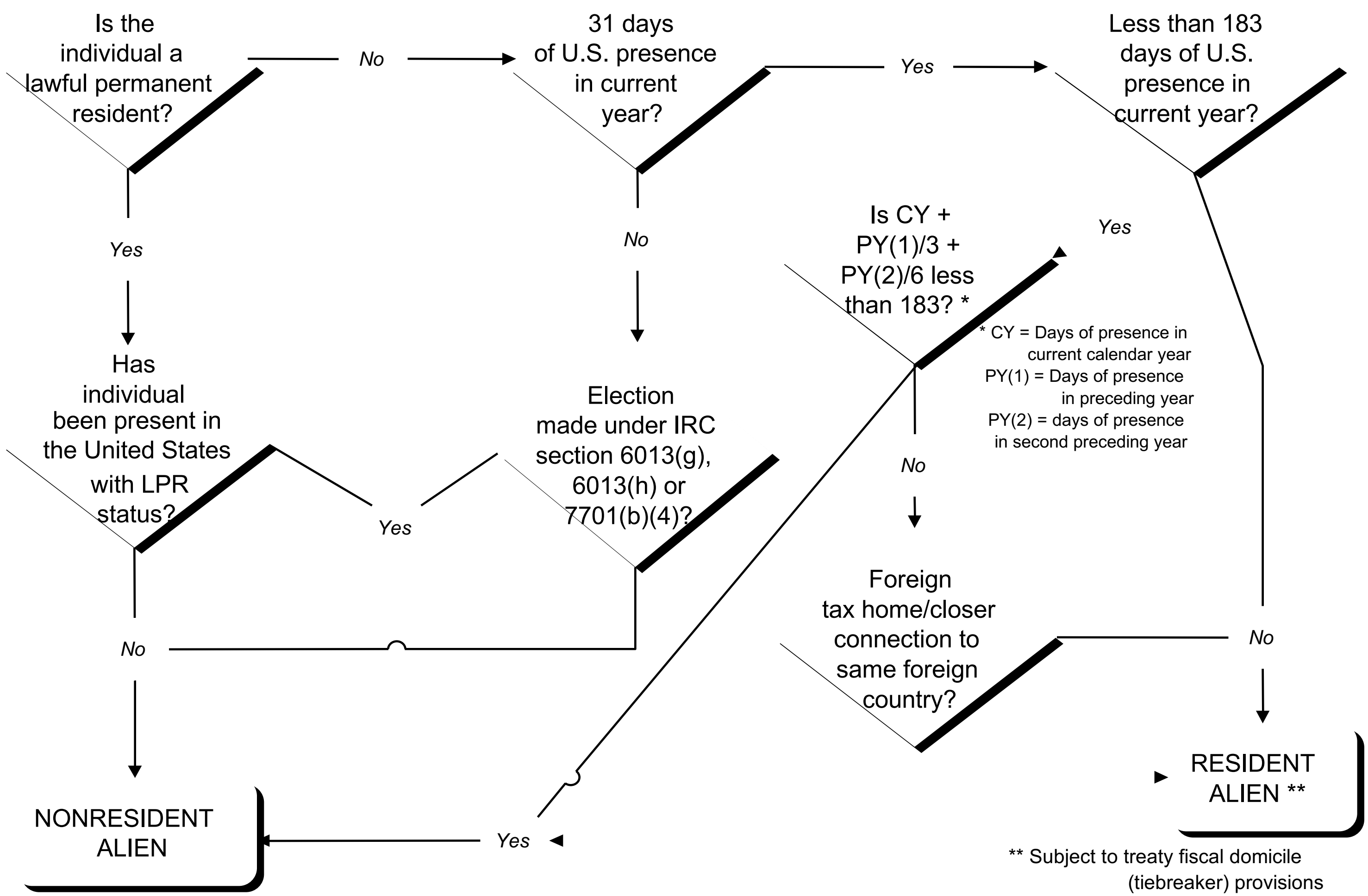
Days of Presence

- Tested on calendar year basis
- Presence during any part of day counts as full day
- Days in transit between two foreign points excluded if stay is less than 24 hours
- Days don't count for some classes of nonimmigrants
  - Students, teachers, diplomats, international organization employees, some professional athletes, regular commuters from Canada or Mexico (special rules for each class)
  - Alien unable to leave because of medical condition which arose while present in the United States
    - Not illness known to alien before coming to United States – so this should be taken into account by medical tourists
    - No exclusion if alien remains beyond reasonable period for making arrangements to leave
    - No exclusion for family members

Foreign Tax Home/Closer Connection

- "Tax home" does not mean tax residence under foreign country's law. It is defined as the taxpayer's regular or, if more than one, his/her principal place of business
- Closer connection focuses on personal connections (location of home, family, belongings, social organizations, bank accounts, driver's license, statements on non-tax documents, etc.)
- Important but not absolutely required that number of days in foreign country exceed number of days in the United States

Diagram of Income Tax Residence Rules



Beginning of Residence

- Substantial presence test: First day of presence in first year in which test is met
- LPR test: First day of physical presence in the United States with the status of an LPR (unless already a resident under substantial presence test)
- Elective residence is possible under:
  - IRC section 7701(b)(4): During testing period beginning on date specified by taxpayer and ending on December 31, 31 days of continuous presence and days of presence in the United States equal to 75% of all days
  - IRC section 6013(g): If at close of year NRA is married to U.S. citizen or resident, both may file joint return with NRA treated as resident for whole year
  - IRC section 6013(h): Two married individuals one or both of whom were nonresident at the beginning of the year but both resident at end of the year may elect to file joint return as residents for the whole year

Tax Treaty Tiebreakers

- What if an individual would be a tax resident of the United States and another country?
- Tax treaties almost always provide a tiebreaker based on the U.S. Treasury Model Income Tax Convention (based on OECD Model)
- First, apply domestic tax laws of each country without regard to treaty
- Then, apply series of tests (see next slide)
- U.S. citizens may escape residence of a foreign country under these tests, but:
  - U.S. citizens living abroad remain subject to U.S. taxation on worldwide income
  - U.S. citizens cannot make treaty claim to foreign country unless they are also "resident" in the United States

Tax Treaty Tiebreakers (cont'd)

- If taxpayer would be resident of both "contracting states" under their respective laws:
  - Deemed resident only of the State in which he has a **permanent home available to him**
  - If he has a permanent home available to him in both States, deemed resident only of the State with which **personal and economic relations are closer (center of vital interests)**
  - If centre of vital interests cannot be determined, or if no permanent home is available to him in either State, deemed resident only of the State in which he has an **habitual abode**;
  - if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the **State of which he is a national**
  - if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by **mutual agreement**

Nonresident Aliens

- *Section 7701(b)(1)(B)*
  - Any individual who is not a U.S. citizen or U.S. tax resident
  - Residence may be affected by treaty residence (“tiebreaker”) provision (*U.S. Model Treaty, Art. 4(2)*)
  - Note laws applicable to long-term LPRs who give up their status or cease to be resident under a treaty – see later slides

No special provision for new or temporary residents

Transfer Taxes (Estate, Gift, GST)

- RAs and U.S. citizens taxed on worldwide assets; NRAs taxed on assets with U.S. situs
  - Note that gift tax does not apply to gifts of intangible assets, including stock of U.S. corporation or interest in a partnership
- Note special GST rules *(Treas. Reg. § 26.2663-2)*
  - Transfer by an NRA is a direct skip only to the extent transfer is subject to estate or gift tax
  - GST applies to taxable distribution or taxable termination only to the extent the initial transfer to trust by an NRA transferor, whether during life or at death, was subject to estate or gift tax
- Tax on gifts and bequests by “covered expatriates” *(section 2801)* – see expatriation slides below

Residence for Transfer Tax Purposes

- The residence of aliens is based on “domicile”
  - “A person acquires a domicile in a place by living there, for even 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.” *Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b)*
  - Intent is key – immigration status can be an important but not decisive indicator of intent

Residence for Transfer Tax Purposes (cont'd.)

- So what effect does immigrant or non-immigrant status have on determination of domicile?
  - LPR – strong indicator of intent to remain indefinitely
  - Nonimmigrant or lack of status – indicates intent to leave but:
    - Undocumented alien - Rev. Rul. 80-209, 1980-2 C.B. 248 and *Estate of Robert A. Jack v. United States*, 54 Fed. Cl. 590 (2002) (granting government's summary judgment motion that it should be allowed to show that the decedent intended to stay in the United States in violation of his visa)
    - Multiple renewals of nonimmigrant visas – *Elkins v. Moreno*, 435 U.S. 647 (1978) (non-tax case involving domicile for succession purposes of holder of G-4 visa for employee of international organization who remained in the United States for many years), cited by IRS in Rev. Rul. 80-36, 1980-2 C.B. 249

Pre-Residence Planning

Overview

- Wherever possible, planning should be undertaken and executed before an alien becomes a U.S. resident
- It is critical to determine exactly when he or she will become a resident and to carry out any tax planning steps that can best be undertaken before residence begins
  - Sometimes, it is possible for an individual to cease to be resident in home country before becoming a U.S. resident and planning can be done during this interim period
- Planning should be coordinated with home country counsel, especially if the country has a departure tax (outside the scope of this presentation)

Principal Pre-Residence Steps

- Accurately time when U.S. tax residence begins for both income tax and transfer tax purposes
- Consider what immigration status is appropriate, given punitive rules applicable to immigrants who become green card holders and become “covered expatriates” if they later leave the United States
- Income timing (consider home country tax effects)
  - Accelerate collection of non-U.S. income
  - Accelerate realization of gains not subject to U.S. tax
  - Basis step-up transactions (U.S. does <u>not</u> have landed basis)
  - Defer realization of losses
  - To the extent necessary and possible, deal with income and gains held in deferred compensation plans

Principal Pre-Residence Steps (cont'd)

- Deal with holdings in foreign corporations, especially corporations that might become controlled foreign corporations (CFCs) or passive foreign investment companies (PFICs) once residence begins
- Deal with trusts that are already in existence, whether formed by the prospective resident or by the new immigrant's family members
- Make gifts and create trusts for spouse and children

Post-Residence Issues

The Big Switch: Inbound to Outbound

- An NRA who becomes a U.S. resident often is making a critical switch:
  - Before residence, the NRA was an inbound investor
  - After residence, the NRA has become an outbound investor with respect to holdings that previously had no U.S. tax consequences and will also be subject to comprehensive and onerous reporting requirements
- Nowhere can the consequences be more wide ranging (and in some cases wildly disadvantageous) than in the case of holdings of private investments
- We will consider two examples: One involving a CFC, the other a PFIC

Case Study 1: From Foreign Corporation to CFC

- Consider the following, rather common, scenario:
- NRA owns F Corp., a successful business abroad
- F Corp. is a corporation under U.S. entity classification rules
- F Corp. establishes a U.S. subsidiary (U.S. Sub), which it capitalizes with a combination of equity capital and short- and medium-term debt
- NRA moves to the United States to grow the business of U.S. Sub
- The foreign corporation continues to be profitable at home

Hardly seems like a dangerous course of action. . . .

But the Result . . .

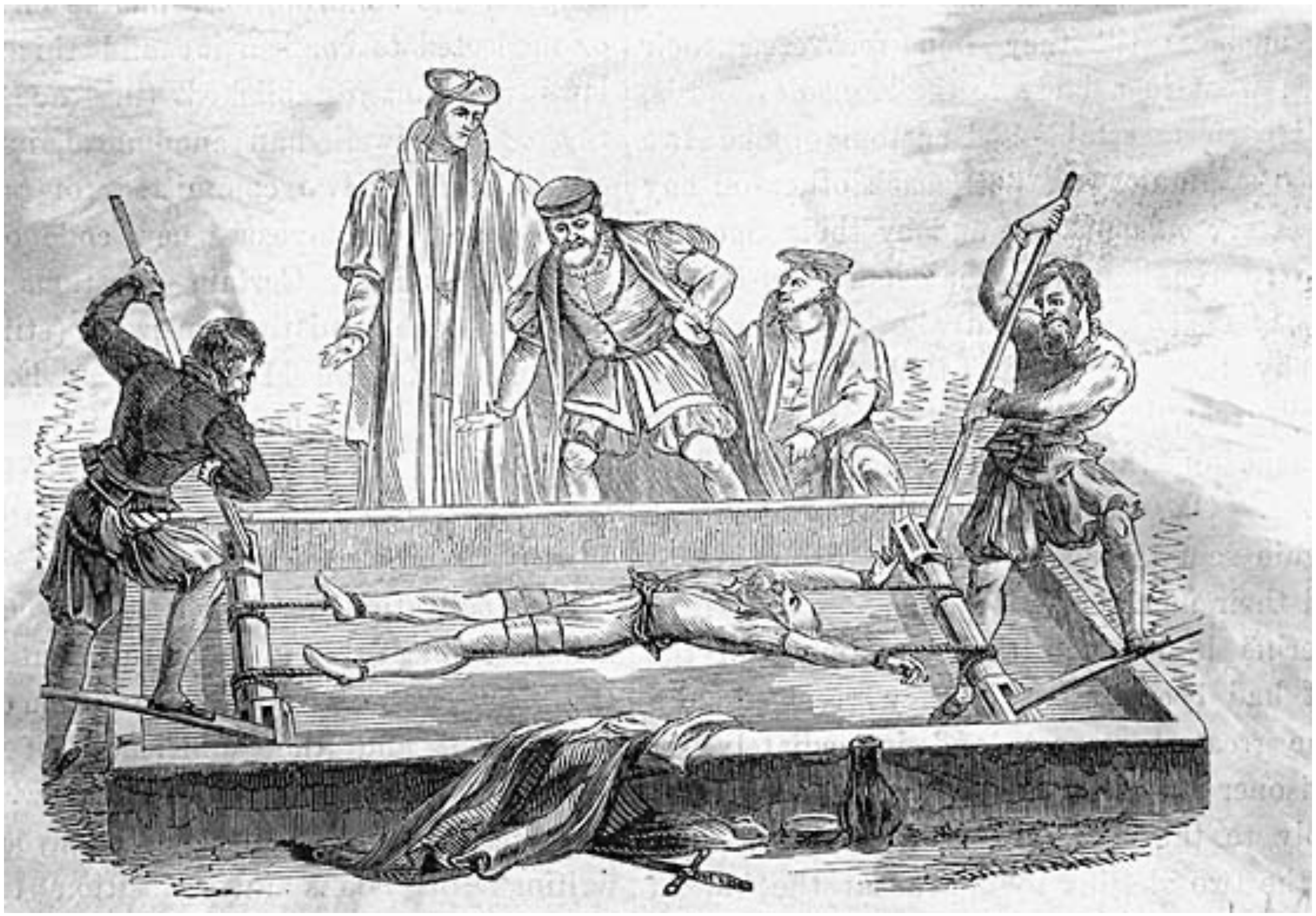
What Happens?

- Before NRA was U.S. resident:
  - United States did not tax NRA on F Corp. income
  - United States taxed F Corp. on dividends from U.S. Sub, but under many treaties only at 5% or even 0%
  - Note: F Corp.'s country did not tax dividends from U.S. Sub (territorial system) or gave credit to F Corp. for U.S. tax on U.S. Sub
- After NRA becomes U.S. resident
  - Undesirable sandwich structure (U.S. person owns foreign corporation that owns U.S. corporation)
  - F Corp. becomes a CFC
  - U.S. taxes NRA (now RA) on F Corp.'s Subpart F income
  - U.S. taxes NRA on his share of F Corp. income, even if not distributed, up to amount of equity and loans provided by F Corp. to U.S. Sub (*Section 956*)
  - Inclusion is <u>not</u> qualified dividend, so taxed as ordinary income

Case Study 2: PFIC

- Foreign family (parents and two children) owns foreign holding company which invests in rental real estate and stocks and shares
- The company pays some salary but reinvests most of the profits, including occasional substantial capital gains
- One child, owner of one quarter of the shares, moves to the United States
- Fact pattern varies
  - Parents do not give much information to children
  - Child who remained behind takes over from parents – U.S. child not much involved in management

And the Result . . . .



F Corp. May Be a PFIC

- All dividends are ordinary income
- Interest charge on tax on “excess distribution”, allocated to every day the F Corp. has been a PFIC
- Excess distribution is:
  - Distribution in excess of 125% of rolling average of distributions in 3 previous years
  - Any gain on sale or exchange of the shares
- Could make “qualified electing fund” (QEF) election
  - Pay tax on QEF’s earnings and capital gains as earned
  - Needs to be made in good time and requires significant cooperation from non-U.S. shareholders
  - No credit for foreign taxes paid by QEF
- Consider instead making “check the box” election to treat F Corp. as partnership – see Appendix

Reporting

- U.S. citizens and RAs are subject to many reporting requirements on foreign activities, including:
  - Form **TD F 90-22.1** (Report of Foreign Financial Accounts) universally known as the FBAR – not a tax form but administered by the IRS
  - Forms **5471** (Information Return of U.S. Persons With Respect To Certain Foreign Corporations) and **8865** (Return of U.S. Persons With Respect to Certain Foreign Partnerships);
  - Form **8858** (Information Return of U.S. Persons With Respect To Foreign Disregarded Entities);
  - Form **8938** (Statement of Specified Foreign Financial Assets), 926 (Return by a U.S. Transferor of Property to a Foreign Corporation);
  - Form **8621** (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund)
  - Forms **3520** (Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts) and **3520-A** (Annual Information Return of Foreign Trust With a U.S. Owner)
- Very heavy penalties and lengthened statute of limitations are associated with these forms

FBAR Overview

- Form TD F 90-22.1 (Report of Foreign Financial Accounts)
- Requirement does not derive from the Internal Revenue Code
- Derives from the Bank Secrecy Act of 1970 codified at 31 USC section 5311 et seq.
- Form is due on June 30 each year, covering the prior calendar year!
- The form and instructions have been modified several times over the years.

Overview of Reporting Requirements - FBARs

- Who must file:
  - A United States person that has:
    - A financial interest in or signature or other authority over
    - Foreign bank or financial accounts if
    - The aggregate value of the foreign financial accounts exceeds $10,000 at any time during the calendar year.
- Who is a United States person?
  - United States citizens and residents (but also includes U.S. territories)
  - Entities including corporations, partnerships or limited liability companies created or organized in the United States and trusts or estates formed under the laws of the United States

FBARs - What Accounts Are Covered?

- 2010 and later years:
  - Accounts with foreign banks and financial institutions.
    - Includes foreign branches of U.S. institutions.
    - But not U.S. branches of foreign institutions.
  - Insurance policies with a cash value issued by foreign insurance company.
  - Annuities with a foreign financial institution.
- What about pensions?
  - Individually owned accounts must be reported.
  - Foreign plans owned or sponsored by employers – uncertain
    - Unfunded plans probably do not need to be reported.
- What about safe deposit boxes? Not covered.

FBAR Penalties

- Willful Failures
  - Willful failure to file:
    - Civil Penalty: the greater of $100,000 or 50% of the account balance at the time of the violation.
    - Criminal Penalty: up to $250,000 or 5 years in jail or both or if the failure to file occurs while violating certain other laws, up to $500,000 or 10 years in jail or both
  - Knowingly and willfully filing false
    - Civil Penalty: the greater of $100,000 or 50% of the account balance at the time of the violation
    - Criminal penalty: $10,000 or 5 years in jail or both
- Non-Willful Failures
  - Up to $10,000 for each negligent violation
- IRS says these penalties are per account – this has not been tested in a court

Form 1040 Schedule B

		Yes	No
	You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.		
Part III Foreign Accounts and Trusts (See instructions on back.)	**7a** At any time during 2011, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		
	If "Yes," are you required to file Form TD F 90-22.1 to report that financial interest or signature authority? See Form TD F 90-22.1 and its instructions for filing requirements and exceptions to those requirements		
	b If you are required to file Form TD F 90-22.1, enter the name of the foreign country where the financial account is located ▶		
	8 During 2011, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions on back		

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 17146N **Schedule B (Form 1040A or 1040) 2011**

- The IRS and DOJ regard this as the ace in the hole – tax returns with box checked "No" combined with non-reporting of income are regarded as an indicator of willfulness in connection with failure to file FBAR.
- Recent government success in the Williams case
- But it's not that simple . . .

Departure and Pre-Departure Planning

Termination of Residence for Tax Purposes

- Substantial presence test: Last day of physical presence in final year test is met (unless alien has become an LPR)
- LPR test: Last day of physical presence in the United States with LPR status (unless resident thereafter under substantial presence test)
- In both cases, residence will continue to end of calendar year unless:
  - During remainder of calendar year, alien has closer connection to foreign country than to the United States
  - Individual is a resident at <u>any</u> time in the next calendar year

Former Citizens and Residents

- All former citizens and former RAs who become NRAs continue to be taxed under rules generally applicable to NRAs
- Special rules applied to "covered expatriates" can result in continued taxation of certain foreign income and enhanced taxation of certain U.S. income
- See also sections 864(c)(6) and (7) – taxation of income and gains earned while engaged in U.S. trade or business but received when no longer so engaged

Taxation of Covered Expatriates

- In 1995, Congress, prompted by President Clinton, got concerned that prior (1966) regime was ineffective
- 1996 to 2008, Congress enacted three major revisions:
  - 1996 (HIPAA) – Added presumption of tax avoidance if 5-year average net income tax exceeds \$100,000 or net worth is \$500,000 or more; extended rules to former "long-term residents"; tightened compliance/reporting
  - 2004 (AJCA) – Eliminated tax avoidance test; increased tax and net worth thresholds to \$124,000 (inflation adjusted – now \$151,000) and \$2,000,000; added short-term residence rule for aliens spending more than 30 days in U.S. in any of 10 years following expatriation
  - 2008 (HEART) – Replaced existing regime with "mark-to-market" tax; added succession tax on gifts/bequests to U.S. persons, directly or via trusts; eliminated 30-day short-term residence rule
- No regs. yet. See Notice 2009-85; 2009-45 I.R.B. 1 and IRS Form 8854 (and instructions)

Taxation of Expatriates - Scope

- Laws apply to **"covered expatriates"**, meaning former citizens who expatriate and to aliens who cease to be LPRs for tax purposes if they have been LPRs <u>in</u> at least 8 years within a 15-year period (*section 877(e)*) – these rules were significantly revised effective 6/17/2008
- Because consequences have changed multiple times since 1995, date of loss of citizenship or LPR status is critical
- Since 2004, objective tests based on net worth, 5-year history of income tax liability and 5-year history of tax compliance have replaced tax avoidance intent

Covered Expatriates

- Definition (since 2004)
  - Average annual net income tax of >$124,000 indexed for inflation (> $151,000 for 2012) for the five tax years preceding expatriation
  - Net worth $2 million or more at date of expatriation (not indexed for inflation)
  - Failure to certify 5 years of tax compliance on Form 8854
- Exceptions
  - Dual citizens at birth who have not met “substantial presence” test more than 10 of 15 prior years and who continue to be citizens of and taxed by other country
  - Persons under 18½ who relinquish U.S. citizenship and have not met “substantial presence” test for more than 10 years before date of relinquishment
    - No similar exception for children who were long-term LPRs

Mark-to-Market Rules – Section 877A

- Exit Tax -
  - Applies to expatriation occurring on or after 6/17/2008
  - Covered expatriate is deemed to sell all worldwide property for FMV on day before expatriation date and is taxed on gains >$600,000 (indexed post-2008 - $651,000 in 2012) net of losses
  - Makes no difference that asset may continue to be subject to U.S. tax, e.g., U.S. real property interest
  - Section 877A does not address character of gain – could be ordinary, short-term or long-term capital gain. $651,000 exclusion must be allocated among different classes of assets, gain on which may be subject to varying tax rates (e.g., capital gain vs. collectibles gain)
  - Limited step-up for assets owned by alien pre-residence

Exceptions to Mark-to-Market Regime

- **"Deferred compensation items"**
  - Includes interests in qualified and non-qualified U.S. and foreign retirement and deferred compensation plans, other deferred compensation, and interests in property for performance of services to extent not previously included under section 83
  - Exception for deferred compensation for non-U.S. services while covered expatriate not U.S. citizen or RA
  - Tax on **"eligible deferred compensation"** deferred until includible in gross income; collected by 30% withholding tax
    - Deferred compensation is "eligible" if paid by U.S. payor or foreign payor electing, under terms acceptable to IRS, to be treated as U.S. payor
    - Covered expatriate must waive applicable tax treaty benefits and notify payor of status
    - Risk of double taxation, although tax credits may be available

Exceptions to Mark-to-Market Regime (cont'd)

- **Non-eligible deferred compensation** is present valued and treated as received day before expatriation
  - Risk of double taxation; likely no tax credit in foreign country when later received
- **"Specified tax deferred account"**, e.g., IRA's, qualified tuition plan, treated as received day before expatriation
  - No early distribution penalties

Exceptions to Mark-to-Market Regime (cont'd)

- Interests in nongrantor trusts
  - Taxable portion of direct or indirect distributions to covered expatriate subject to 30% withholding tax
  - Applicable whether U.S. or foreign trust
    - How will IRS collect from foreign trust?
  - Recipient must be beneficiary *prior to* expatriation date; will be treated as having waived tax treaty benefits
  - If trust distributes appreciated property, treated as sale of property to recipient
  - No exception for grantor trusts – assets are treated as belonging to expatriate grantor and are marked to market
    - If nongrantor trust becomes grantor trust of covered expatriate, treated as distribution to covered expatriate

Section 2801: New Succession Tax

- Gifts and bequests to U.S. persons from covered expatriate under section 877A taxed to recipient at highest gift or estate tax rate
  - Exceptions for gifts within annual exclusion (currently $13,000) or entitled to charitable or marital deduction
    - Must bequests to resident alien spouse go into QDOT?
  - Exceptions also for property shown on timely filed gift tax return of covered expatriate or included in gross estate of covered expatriate and shown on timely filed estate tax return
  - Credit for foreign gift or estate/inheritance taxes
- Section 2801 often a bigger disincentive to expatriation than section 877A

Section 2801: New Succession Tax (cont'd)

- Special rule for transfers in trust:
  - If domestic trust, tax paid by trust
  - If foreign trust, tax paid by U.S. recipient on distribution portion attributable to covered expatriate's prior transfer in trust
  - U.S. recipient can deduct section 2801 tax attributable to income in computing income tax liability on distribution
  - Foreign trust can elect to be treated as domestic trust
- How will IRS monitor transfers by covered expatriate long after expatriation?

Can Any of This Be Planned For?

- Consider not becoming an immigrant unless and until sure that residence will indeed be permanent
  - This prevents 8 years beginning to run
  - May avoid RA becoming domiciled for transfer tax purposes
- In connection with departure:
  - Take steps to reduce net worth below $2 million, e.g., by splitting assets with spouse, pre-departure gifts within unified credit limit, etc.
  - Take steps to minimize valuation of assets (to reduce mark-to-market tax)
  - Possible use of non-grantor trust
  - For an interim period, retain LPR status but not U.S. domicile – make gifts to U.S. relatives during this period

Appendix: QEF v Check-the-Box

	QEF election by U.S. direct or indirect shareholders of F Corp.	F Corp. Makes Check-the-Box Election
Who makes the election	QEF elections are made individually by U.S. members of F Corp.	F Corp. makes the election; generally, no shareholder consent required
Election applies to	Each U.S. member can decide whether or not to elect	Election applies to all U.S. members
Effect on non-U.S. investors	None	None
Timing	Made on U.S. member’s timely filed tax return for the first year he owned an interest in the QEF	Made by F Corp. no later than 75 days after the desired effective date of the election. Effective date should be prior to first date they have business activity. Late filing possible – must follow Rev. Proc. 2009-41; IRS quite liberal in practice
What income is included	U.S. member’s pro rata share of (i) net capital gain of the QEF’s taxable year plus (ii) the balance of the earnings and profits not attributable to net capital gain	U.S. member’s allocable share of F Corp.’s net income and gains
Treatment of sale of F Corp. asset	Net capital gain taxed as long-term capital gain only to the extent gain exceeds depreciation recapture	Net capital gain taxed as long-term capital gain only to the extent gain exceeds depreciation recapture
Treatment of sale of F Corp. stock	Long-term capital gain	Long-term capital gain
Information	QEF election invalidated if F Corp. does not provide “PFIC Annual Information Statement” described in Treas. Reg. § 1.1295-1(g)	Check-the-box election not invalidated by failure of F Corp. to provide information to U.S. direct or indirect shareholders
Other issues	(i) No foreign tax credits in the event any F Corp. income taxed by foreign country (ii) No issues for U.S. tax-exempts	(i) Any foreign tax credits would flow through to U.S. members (ii) U.S. tax-exempts, e.g., IRAs, pension plans, non-profits, may have heavily taxed “UBTI” which may make deal unattractive

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To ensure compliance with requirements imposed by the IRS, we inform you that, unless and to the extent we otherwise state, any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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

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