

THREE TRAPS WHEN SENDING CLIENTS OR FUNDS TO THE UNITED STATES

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Relevant Scenarios

- Non-U.S. clients or clients' family members traveling to the U.S. for studies but end up staying and becoming U.S. residents (and later green card holders)
- Non-U.S. clients making substantial gifts to their U.S.-resident family members
- Non-U.S. clients or ancestors set up a foreign trust for the benefit of family members, and one such members became a U.S. resident

Becoming a U.S. Resident – Tax Aspects

Tax consequences include:

- U.S. tax jurisdiction over worldwide income and gains
- U.S. reporting of receipt of foreign gifts and distributions from foreign trusts
- U.S. reporting of foreign financial accounts if:
 - Financial interest in account, or
 - Signatory authority over account

Becoming a U.S. Resident – Tax Aspects

- U.S. reporting information on $\geq 10\%$ -owned foreign corporations and partnerships
- Potential application of controlled foreign corporation rules and P.F.I.C. rules
- Estate tax on worldwide assets
- Expatriation tax for citizens and green card holders who are “long term residents”

U.S. Tax Residence

- U.S. tax residency determined by one of the following
 - U.S. citizenship
 - Substantial presence test
 - Green card
- Foreign nationals coming to study in the U.S. are not U.S. residents for the duration of their study
 - Student visa
 - Up to five years, and possibly a sixth year for working experience under an O.P.T. visa
 - Staying in the U.S. thereafter would result in becoming a U.S. resident

Foreign Students Trap

- While a student:
 - No tax on foreign source income
 - No reporting on foreign gifts
 - No reporting on foreign financial accounts
 - No tax on receipt of gratuitous payments from foreign corporations and partnerships
- Trap – those who stay in the U.S. after graduating their studies and exhausting the O.P.T. will become a U.S. residents
 - All information reporting requirements apply
 - Substantial penalties for noncompliance
 - Gratuitous payments from foreign corporations are taxable as dividends
 - Gratuitous payments from foreign partnerships are taxable as income

Green Card – Long Term Traps

- Trap – a green card holder residing in the U.S. for certain amount of time becomes a “long term resident”
 - U.S. expatriation rules apply to U.S. citizens and long term residents
 - Other visas should be exhausted before green card is obtained

Green Card Trap – Long Term Resident

- A long term resident is a green card holder in eight taxable years out of the last 15 taxable years
- If foreign individual held a green card at any time within prior 15-year period, relinquished the card, and subsequently reapplies, the prior years within 15-year period can be taken into account in determining status as a long term resident
- Even one day of presence in the U.S. with a green card during a taxable year can cause the taxable year to count in full
- Once long term resident, expatriation rules could apply when green card is relinquished

Relinquish Green Card After Being Treated as Long Term Resident

- Expatriation rules apply if:
 - Net worth over 2 million U.S. dollar, or
 - Average income tax over last five years was \$157,000 (adjusted by inflation) or more, or
 - Fails to state under penalties of perjury that he has complied with all U.S. federal tax obligations for the five years preceding the expatriation
- If rules apply:
 - “Exit tax” – deemed sale of worldwide assets at fair market value
 - “Succession tax” – gifts and bequest made by client to U.S. persons will be subject to gift tax or inheritance tax by recipient
 - Even if assets were acquired after expatriation
 - Applicable rate – the highest rate applicable at the time for gift or estate tax
 - Inclusive v. exclusive

U.S. Gift Tax

- Applies to donors, with the exception of gifts received from non-U.S. persons who were covered by the expatriation rules
- Gifts that exceed \$100,000 require reporting by the U.S. recipient
- Non-U.S. donors are subject to U.S. gift tax on gifts of tangible property located in the U.S. and U.S. situs real property
- Gifting of an intangible asset is not subject to gift tax by non-U.S. donors
 - Stock
 - Money

U.S. Gift Tax Trap

- Trap – not all gifts of money are equal
 - Actual currency is a tangible assets and would be subject to gift tax
 - Wire transfer is treated as an intangible and is the preferred method to be used for gifting U.S. persons
- Trap – transferring cash by wire from a non-U.S. parent's offshore company to a U.S. child will be treated as dividend
- Tip: if a non-U.S. client wishes to purchase an apartment in the U.S. for his U.S. child he should gift him with the funds to buy the apartment rather than with the apartment

Foreign Trusts

- Wealthy families often settle irrevocable discretionary foreign trusts to benefit their family members and their issues
 - Those trusts are settled in low tax jurisdictions
- The accumulated income is distributed to beneficiaries at the discretion of the trustee at certain age or at certain events (studies, wedding, medical etc.)
- The beneficiaries are either not taxed or are subject to income tax on the amount received, depending on the tax laws of their country of residence

Foreign Trusts Trap

- Trap - in the U.S., distributions of accumulated income from a foreign irrevocable trust are subject to extremely high rates of tax
 - Favorable capital gains tax rate are not applicable
 - The distribution will be allocated to the years of accumulation and interest will be charged on the deemed late tax resulting in very high effective tax
 - Compliance costs for calculating the tax are very high
- These rules do not apply if the foreign trust is a grantor trust with one of the parents as the grantor
 - Must be revocable, or
 - Must provide that distributions can be made solely to the grantor or to spouse

Foreign Trusts Trap

- At the conclusion of the grantor's lifetime a grantor trust will become irrevocable and be treated as a nongrantor trust
- Tip – domesticate the trust
 - U.S. trustees
 - U.S. advisors
 - U.S. court control

Q&A

The End

Circular 230 Statement

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