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ATTORNEYS AT LAW
FOR THE INTERNATIONAL PRIVATE CLIENT

Travails of the International Executive: How US Tax and Reporting Requirements Can Sometimes Hamper Career Plans

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Inbound Foreign Executive Transferred to the United States

Resident/Nonresident
Domiciliary/Nondomiciliary

- RESIDENT
- DOMICILIARY

Why a Frown?

- NONRESIDENT
- NONDOMICILIARY

Why a Smile?

Resident For U.S. Income Tax Purposes

- **U.S. Citizen**
- **Green Card**
- **Physical presence**
- **Substantial presence**
- **Election**

- **Exceptions:**
  - Closer connection
  - Treaty-based position
  - Days not counted

Resident For U.S. Estate and Gift Tax Purposes

- Domicile: means physical presence AND intent to remain indefinitely
- Facts and circumstances test
- Treaty-based position

Residency Starting Date

- Substantial Presence Test
  - First day of presence in current year is residency starting date
  - Must not have been a U.S. resident in prior year
  - Certain days are excluded for residency starting date, but not for overall day count
- U.S. permanent resident (green card holder)
  - Date entered U.S. as a permanent resident is residency starting date
  - Must not have been a U.S. resident in prior year
- Overlap – If green card holder meets substantial presence test

Complications of U.S. Tax System

Taxation on Worldwide Income

- **Salary**
- **Relocation bonus**
- **Certain reimbursed costs**
- **Tuition reimbursements**
- **Employer-paid housing or use of employer-owned housing**
- **Personal use of vehicle provided by employer**
- **Certain moving allowances**

Taxation on Worldwide Income

- Salary for work performed outside the United States
- Interest regardless of where derived
- Dividends regardless of where derived
- Rents and Royalties regardless of where derived
- Capital Gains regardless of where derived (including exercise of certain stock options)
- Foreign Exchange Gains
- Distributions from certain trusts
- Special Issues
  - Controlled Foreign Corporations – Subpart F
  - Passive Foreign Investment Companies

Taxation on Worldwide Income

- De minimis exemption
  - No more than 90 days
  - No more than US$3,000
  - Must be paid by a foreign employer
- United States Income Tax Treaties

Barbados	183 days	US$5,000
Canada	183 days	US$10,000
Jamaica	183 days	US$5,000
Mexico	183 days	no limit
Trinidad/Tobago	183 days	US$3,000
Venezuela	183 days	no limit

Taxation on Worldwide Income

- **Personal Exemptions**
- **Standard Deduction vs. Itemized Deductions**
- **Credit for foreign taxes**
  - **Generally limited to U.S. tax on foreign source income**

Taxation on Worldwide Income

- **Common Itemized Deductions**
  - **Trade or business expenses**
  - **Certain away-from-home expenses**
  - **Certain moving expenses**
  - **Medical expenses (in excess of 7.5% of adjusted gross income)**
  - **State and local income taxes or sales taxes**
  - **Real estate and tangible property taxes**
  - **Charitable contributions**
  - **Home mortgage interest**
  - **Certain miscellaneous deductions**

Other Taxes and Issues

- State and Local Taxes
  - Income Tax
  - Sales Tax
  - Personal Property and/or Real Property Tax
  - Death/Estate Tax
- Social Security Tax (FICA and Medicare)
  - Totalization Agreements
    - Canada
    - Chile
  - Certificate of Coverage
- Self Employment Tax

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Planning Strategies

Know Your Client

- **Family**
- **Assets**
- **Business**
- **Citizenship, Residence and Domicile of all family members**
- **Investment Objectives & Diversification**
- **Tax and non-tax objectives**
- **Date of change of residence**

Objectives

- Minimize United States and Home Country taxes
  - Consult with local counsel
  - Consider interim residence
  - Least aggregate amount of taxes in both countries and avoid double taxation to the greatest possible extent
- Coordinate tax and estate plan with non-tax issues
  - Family relationships
  - Cash flow
  - Access to assets
  - Understand United States financial disclosure and other relevant laws
- Maximize protection from creditors
- Address spousal rights, if any

Accelerate Income and Gains

- Income and gains realized prior to becoming a resident will not be subject to United States income tax if not ordinarily subject to such tax
  - Identify key assets and income sources
  - Determine expected time of ownership
  - Difficulty in determining historic cost
  - Appreciated marketable securities
  - Rents and royalties
  - Review existing life insurance and deferred compensation products/plans

Defer Deductions and Losses

- Sale of assets having built-in losses should be deferred until after becoming a resident
- Deductible expenses should be paid after becoming a resident
  - Business expenses
  - Mortgage payments
  - Charitable contributions

Sale of Residence

- $250,000 of gain from the sale of property is excluded if, during the 5-year period ending on the date of the sale, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more
- Up to $500,000 if filing married and filing jointly.
- Income tax issue: if U.S. home is owned by corporation, consider selling to client to take advantage of this exclusion in the future
- Estate tax issue: if U.S. home is owned by foreign corporation…protection from estate tax (but client should rent property)

Outright Gifts to Third Parties

- Avoids inclusion in donor's gross estate
- Donor will not be subject to tax on income from assets
- Not subject to United States gift tax if assets are not situated in the United States and donor not domiciled in the United States at time of gift
- Ensure gift is "complete"
  - Dominion and control
  - Claim of creditors
- Gifts to spouse to equalize estate

Gifts in Trust

- May avoid inclusion in donor's gross estate (depends upon powers retained or given, i.e., power to revoke or power of appointment)
- Donor may not be subject to tax on income from assets (i.e., if irrevocable domestic trust or foreign trust, but no U.S. beneficiaries)
- Not subject to United States gift tax if assets transferred to trust are not situated in the United States and donor not domiciled in the United States at time of gift
- Beware of Drop-Off Trusts

Gifts in Trust (Continued)

- Grantor can be a discretionary beneficiary of irrevocable trust
- Foreign vs. Domestic trusts
  - Citizenship and residence of beneficiaries is important
  - Reporting requirements
- Ensure gift is "complete"
  - Dominion and control
  - Claim of creditors

U.S. Pre-Immigration Planning – Basis Step-Up

- Step up the basis of assets which have large built-in gains
- Check-the-Box Election technique for existing companies
- Check-the-Box Election for other assets
- Additional gain recognition techniques

U.S. Pre-Immigration Planning – Anti-Deferral Regimes

- **Changing the ownership of a particular foreign corporation so that it will no longer constitute a CFC**
- **PFICs – sell foreign mutual funds prior to entry**
- **Check-the-box election**
- **Liquidation**

How to Maintain Non-U.S. Domicile (if desired)

- Facts and circumstances
- Maintain contacts in home country
  - Residence
  - Business interests
  - Other assets
  - Social memberships
  - Religious organizations
  - Statement in will/trusts as to domicile

Pitfalls to Avoid

- Failing to plan in advance before arriving in the U.S.
- Failing to verify the domicile and tax status of all members of the family
- "My brother is back at home with my money"
- Certain distributions directly from foreign companies
- Tax return and informational return filing obligations for U.S. residents
  - 1040
  - 8938 (SFFA)
  - 5471 (CFC), 8865 (CFP), 8858 (FDE)
  - 8621 (PFIC)
  - 3520 & 3520-A
  - TD F 90-22.1 (FBAR)

Outbound Foreign Executive Transferred from the United States

Taxation on Worldwide Income

- **U.S. citizens and green card holders living abroad continue to be taxed on their worldwide income and are required to file all applicable U.S. income tax and information reporting returns, including FBARs**
- **The calculation of income, gains, exemptions, deductions, and credits is very much the same as for individuals living in the United States**
- **The executive will likely be subject to income tax in the foreign country as well and will have to rely on some special rules in the U.S. law to relieve them from the burden of double taxation**

Foreign Earned Income Exclusion

- Qualified individuals may exclude up to US$95,100 of foreign earned income in 2012
- Qualifications
  - Tax Home Test
  - Bona Fide Residence Test or Physical Presence Test
- Tax home is your regular or principal place of business, employment or post of duty, regardless of where you maintain your family residence

Foreign Earned Income Exclusion

- **Bona Fide Residence Test**
  - **U.S. citizen living in a foreign country or countries for an uninterrupted period that includes and entire calendar year**
  - **Resident alien who is a citizen or national of a treaty country living in a foreign country or countries for an uninterrupted period that includes and entire calendar year**
  - **Depends on intent**

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Foreign Earned Income Exclusion

- **Physical Presence Test**
  - **U.S. citizen or resident alien who is physically present in a foreign country or countries for at least 330 full days during any 12 consecutive month period**

Foreign Earned Income Exclusion

- **Foreign Earned Income**
  - **Wages and Salaries**
  - **Professional Fees**
  - **Other compensation for personal services**
  - **Self employment income**
- **Does not include**
  - **Allocation of salary for business days worked in the U.S.**
  - **Passive Income (Dividends, interest, capital gains, etc.)**
  - **Pension and annuity income (including social security)**
  - **Employment related amounts received from the U.S. Government**
  - **Nonqualified benefits**

Foreign Housing Exclusion

- **An exclusion from income is allowed for the reasonable foreign housing expenses incurred in an amount above a specified floor and below a specified ceiling**

Limit on Housing Expenses Worksheet—Line 29b *Keep for Your Records*

Note. If the location in which you incurred housing expenses is not listed in the table beginning on page 5, and the number of days in your qualifying period that fall within the 2011 tax year is 365, DO NOT complete this worksheet. Instead, enter $27,870 on line 29b.

1. Enter the number of days in your qualifying period that fall within the 2011 tax year (see the instructions for line 31) . . . . **1.** ________
2. Did you enter 365 on line 1?
   - ☐ **No.** If the amount on line 1 is less than 365, skip line 2 and go to line 3.
   - ☐ **Yes.** Locate the amount under the column *Limit on Housing Expenses (full year)* from the table beginning on page 5 for the location in which you incurred housing expenses. This is your **limit on housing expenses.** Enter the amount here and on line 29b.

   STOP Do not complete the rest of this worksheet . . . . **2.** ________
3. Enter the amount under the column *Limit on Housing Expenses (daily)* from the table beginning on page 5 for the location in which you incurred housing expenses. If the location is not listed in the table, enter $76.36 . . . . **3.** ________
4. Multiply line 1 by line 3. This is your **limit on housing expenses.** Enter the result here and on line 29b . . . . **4.** ________

Instructions for Form 2555 (2011) -3-

Foreign Housing Exclusion

- **Excludable Housing Expenses Include**
  - **Rent**
  - **Utilities (other than telephone charges)**
  - **Real and personal property insurance**
  - **Nonrefundable fees paid to obtain a lease**
  - **Rental of furniture and accessories**
  - **Residential parking**
  - **Household repairs**

Foreign Housing Exclusion

- **Excludable Housing Expenses do not include**
  - **Deductible interest and taxes**
  - **Cost of purchase of home or improvements**
  - **Principal payments on a mortgage**
  - **Depreciation**
  - **Domestic labor**
  - **Pay television**
  - **Furniture or accessories purchased**

Foreign Earned Income/Housing Exclusion

- **Other miscellaneous rules**
  - **Foreign tax credits reduced**
  - **Itemized deductions limited if directly related to foreign earned income**
  - **Tax on excess income computed at tax rate as if the exclusion was not applied.**
  - **Although self employment income qualifies for exclusion, it is still subject to self employment tax**

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Planning Strategies

Objectives

- Minimize United States and Home Country taxes
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  - Consider interim residence
  - Least aggregate amount of taxes in both countries and avoid double taxation to the greatest possible extent
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  - Understand United States financial disclosure and other relevant laws
- Maximize protection from creditors
- Address spousal rights, if any

What to do with Principal Residence

- Sale of home to qualify for the $250,000 ($500,000 if filing joint) exclusion of gain on sale of principal residence
- Rental of principal residence while on foreign assignment

Other issues and ideas

- **Determine timing of income and expenses items between U.S. residence period and foreign assignment**
- **Consider host country estate and gift tax laws prior to departure**
- **If a totalization agreement applies, consider a certificate of coverage to continue paying into U.S. social security rather than host country program**
  - **Totalization agreements help avoid double taxation and gaps in coverage and benefits**
- **Expatriation**

Circular 230 Disclosure

Pursuant to requirements related to practice before the Internal Revenue Service, any tax advice contained in this communication (including any attachments) is not intended to be used, and cannot be used, for the purposes of (i) avoiding penalties imposed under the United States Internal Revenue Code or (ii) promoting, marketing or recommending to another person any tax-related matter.

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