CARLTON FIELDS

# U.S. Pre-Immigration Tax Planning

# You should engage in tax planning before you arrive in the United States.

There are no adverse consequences, other than transaction costs, to engaging in tax planning before immigrating to the United States. However, there may be significant adverse tax consequences if you fail to engage in any tax planning before moving to the United States, and these consequences significantly outweigh the transaction costs of pre-immigration tax planning.


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# The U.S. Tax Code

The U.S. Tax Code was written with an implicit understanding that wealthy individuals would engage in tax planning in order to minimize taxes. Planning to minimize taxes is not considered tax evasion in the United States, but failing to report taxes is and it carries significant penalties. Tax planning is a part of the "American Way." If an individual fails to engage in tax planning, that person is essentially donating to the U.S. Treasury the excess taxes that he or she should have saved.

The United States utilizes a reporting-based tax system. The federal government does not compile a taxpayer's financial information, such as balance sheets and bank account statements.

Rather, the taxpayer uses that financial information to complete and submit a tax return. There are various tax forms that must be filed depending on the taxpayer and the type of income earned, but one thing that all forms have in common is that they do not require the preparer to input raw financial data. Instead, the preparer compiles the relevant information, performs certain computations, and then submits the output on the form.

The U.S. government will not "look behind" the tax form(s) submitted unless there is evidence that the information submitted is inconsistent or fraudulent. Even then, the Internal Revenue Service is limited in the type and amount of information that it can review and request from the taxpayer.

The U.S. federal government imposes three major taxes: the Federal Income Tax, the Federal Estate Tax, and the Federal Gift Tax. Local governments, such as states and municipalities, may also impose their own taxes, but the federal tax rates are significantly higher than the state and municipal tax rates.

## Income Tax

The United States taxes its citizens and tax residents on their worldwide income. The United States also taxes non-residents on income derived from the United States, including income from a U.S. trade or business and income from certain investments in U.S. real property.

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Long-term capital gains (gains on property held for more than one year) are taxed at graduated rates, with a maximum rate of 20 percent. Short-term capital gains (gains on property held for less than one year) and ordinary income are taxed at graduated rates, up to a maximum rate of 39.6 percent. In addition to the rates above, there is a .09 percent Medicare surtax on wages and self-employment income and a 3.8 percent net investment income tax on certain “passive” income.

The United States also taxes corporations, both U.S. corporations and foreign corporations doing business in the United States. Corporations are taxed at graduated rates up to a maximum rate of 35 percent.


THE TREASURY DEPARTMENT

Notwithstanding the corporate-level tax, the United States imposes a secondary tax on a corporation's shareholders upon receipt of corporate dividends.

In the case of non-residents, the secondary tax rate is 30 percent unless reduced by income tax treaty. In the case of U.S. tax residents, the secondary tax rate is 39.6 percent but earnings from certain U.S. corporations and corporations in certain treaty countries are taxed at a reduced rate of 20 percent.

## *U.S. Income Tax Resident*

U.S. residency for income tax purposes and U.S. residency for immigration purposes are not the same. With certain exceptions, a person who acquires a green card (even a conditional green card) is treated as an income tax resident the minute that the person arrives in the United States. Even a noncitizen that does not have a green card can be subject to income tax in the United States if that person spends the requisite number of days in the United States.

Under the substantial presence test, a person present in the United States for 183 or more days during a calendar year is a U.S. tax resident in that year. But even a person who is present in the United States for less than 183 days during a single tax year may be a U.S. income tax resident in that year if that person spends at least 31 days in the United States in the current year and, by application of a certain carryover formula, the sum of the days in the United States in the current year plus the number of days from the prior two years equals 183 days or more. Under the carryover formula, days from the current year (“Year 3”) are counted at their full value, while days from the immediately preceding calendar year (“Year 2”) are counted as 1/3 of a day, and days from the second preceding calendar year (“Year 1”) are counted as 1/6 of a day.

## *Example*

Mr. X spends 40 days in the United States in Year 3, 300 days in Year 2, and 300 days in Year 1. Mr. X will be a U.S. tax resident in Year 1 and Year 2 because he spent more than 183 days in the United States in each of those years. Mr. X will also be a U.S. tax resident in Year 3 because he spent more than 31 days in the United States in Year 3 and the carryover formula yields a result greater than 183:

| Year 3 | | Year 2 | | Year 1 | | Total |
|---|---|---|---|---|---|---|
| 40 | + | 300/3 | + | 300/6 | = | 190 |

## *Noncitizens Who Are Not U.S. Income Tax Residents*

Even foreigners who do not meet the income tax residence test can be subject to U.S. income taxation on certain income from U.S. sources, including royalties, rents from investments in U.S. real property, compensation for services rendered in the United States, dividends, interest, and income from U.S. business operations. The United States accomplishes this "source-based" form of taxation by requiring the payor to deduct and withhold taxes at a flat 30% rate.

# Estate and Gift Tax

In addition to the Federal Income Tax, the United States also taxes U.S. citizens and estate and gift tax residents on gifts made during their lifetimes and on their property, wherever located, when they die. Noncitizens who are not estate and gift tax residents are also subject to the Federal Estate Tax and Federal Gift Tax on property located in the United States.

The federal estate tax and the federal gift tax each have a maximum rate of 40 percent.

## *Estate and Gift Tax Resident*

Unlike the residency test described for income tax purposes, the U.S. estate and gift tax regime has a different test. In order to be an estate and gift tax resident, a person must be physically present in the United States with the "intent" to remain there permanently. If a person dies while an estate and gift tax resident, the worldwide assets of that person will be subject to the estate tax regardless of whether that person was an income tax resident.

The test for becoming an estate and gift tax resident, a subjective test based upon objective factors, may be broader and narrower than the objective, income tax residency test.

## *Example:*

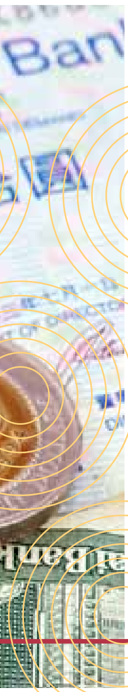
If Mr. X, a foreign citizen, moves to the United States on December 30, 2011, with the intent to stay there permanently, he will be an estate and gift tax resident the minute he arrives in the United States. If Mr. X dies on December 31, 2011, a day after he arrives in the United States, all of his assets will be subject to the U.S. Federal Estate Tax. In contrast, if Mr. X moves to the United States and lives there without interruption for 3 years, but he intends to permanently return to his home country in Year 4, he will not become an estate and gift tax resident even though he will be a U.S. income tax resident during that time period. If Mr. X dies in the United States before moving back to his home country, only the assets that he owns that are located in the United States will be subject to the Federal Estate Tax.

## *Noncitizens Who Are Not Estate and Gift Tax Residents*

When a noncitizen who is not an estate and gift tax resident dies, that person's estate is taxable on all U.S. property to the extent the value thereof exceeds $60,000. Noncitizens who are not estate and gift tax residents are also subject to the Federal Gift Tax on transfers of tangible property located in the United States. Notably, cash is considered tangible property.


# Pre-Immigration Considerations

Carlton Fields, a leading firm in the United States that is over 100 years old, provides pre-immigration tax planning for persons immigrating to the United States in an effort to minimize their U.S. taxes and preserve their wealth. Following are some of the methods we employ to minimize such taxes.



## *Example*

Two individuals, Mr. X and Mr. Y, each bought property many years ago and each paid $10 million for such property. Both Mr. X and Mr. Y plan to move to the United States and reside there for several years on a green card. On the date that they plan to move to the United States, each property is worth $200 million. Mr. X hired a U.S. tax advisor that helped him structure a transaction that would be treated as a sale for U.S. tax purposes but that has no tax consequences in his country of origin. Accordingly, upon moving to the United States, Mr. X is deemed to have purchased the property for $200 million rather than $10 million and will only recognize U.S. gain to the extent that he sells the property for more than $200 million in the future. Mr. Y, however, did not engage a U.S. tax advisor.

Both individuals move to the United States still owning their respective properties. Several years later, each property is worth $250 million, and both Mr. X and Mr. Y decide to sell their respective properties for $250 million each. Mr. X pays $10 million in taxes because he is taxed at 20% (the long-term capital gains tax rate) on the $50 million increase in value from the date that he moved to the United States. Mr. Y pays $48 million in taxes because he is taxed at 20% on $240 million, the full appreciation of the property since he originally purchased it for $10 million. Because Mr. X did pre-immigration tax planning, he was able to eliminate the U.S. income tax on the gain attributable to the period before he moved to the United States and thereby save $28.5 million in U.S. taxes, while Mr. Y was not.

## *Basis Step Up*

In order to minimize U.S. taxation of any assets that have appreciated in value since they were acquired, a person moving to the United States may utilize a planning technique for U.S. tax purposes that has no tax consequences in his or her country of origin. Essentially, the individual engages in a transaction prior to moving to the United States that is treated as a sale of the property for U.S. purposes, but is not treated as a taxable transaction for foreign country purposes.

This technique increases the cost basis of an asset to its fair market value immediately before the move to the United States thus eliminating the potential U.S. tax on any appreciation that occurred prior to the date of the move.

In order to engage in this basis step-up transaction, it will be necessary to obtain an appraisal in order to determine the fair market value of the property transferred. The appraisal will take some time and will cost money. The sole purpose for the appraisal is for the U.S. tax return preparers to establish the proper value of the property.

The appraisal and sale will not be revealed to the foreign government, as the sale is not considered a sale by the foreign government. Additionally, the ownership of the property need not be disclosed to the appraiser or to the foreign government.

*Because Mr. X did pre-immigration tax planning, he saved $28.5 million in U.S. taxes.*

## *Foreign Tax Credit*

For business holdings in high-tax jurisdictions outside the United States, the earnings therefrom are first taxed in that jurisdiction, and once again in the United States (at rates up to 35%) when the earnings are distributed to the U.S. resident. However, certain structures would allow the U.S. resident to credit the foreign taxes against his or her U.S. taxes, virtually eliminating any U.S. taxation of the earnings therefrom. By making an election to treat a foreign entity as a disregarded entity for U.S. tax purposes, an individual can credit the foreign taxes paid by the entity against the individual's U.S. income taxes on the same foreign income.

In general, other than a very short IRS form describing the name and address of the entity, the documentation regarding the entity making this election is private. Occasionally, a change of entity is required, but even then, an accountant reports his or her conclusions on the filing rather than the information upon which such conclusions are based.

## *Example*

Two individuals, Mr. X and Mr. Y, each wholly owns a corporation organized in Country A, a jurisdiction that taxes corporate earnings at 50% but that does not tax dividends when they are issued to shareholders. Each also acquires a provisional green card and desires to move to the United States. Before moving, Mr. X engages a U.S. tax advisor who helps him elect to treat his corporation as a flow-through entity for U.S. tax purposes. Mr. Y does not engage a U.S. tax advisor and therefore does not make an election to treat his corporation as a flow-through entity. While in the United States, each corporation earns $50 million.

Because he made the flow-through election, Mr. X avoids double taxation; he is personally taxed on the earnings of the corporation when the corporation earns them rather than when the earnings are distributed to him. Therefore, Mr. X owes $19.8 million of U.S. taxes (39.6% of $50 million). However, because Country A taxes the earnings at 50%, Mr. X may eliminate all of the U.S. taxes he owes and has an additional $7.5 million ($25 million of Country A taxes minus $17.5 million of U.S. taxes) of foreign tax credit that he may use to offset foreign source income in prior or later years.

Mr. Y, however, failed to make the flow-through election and therefore the distinction between a corporation and its shareholder is maintained for U.S. tax purposes. Country A will tax the earnings at the corporate level at 50%. Because Mr. Y is a U.S. tax resident and he wholly owns the Country A corporation, the U.S. anti-deferral rules apply and he is deemed to receive a dividend from the corporation, which dividend is subject to a 39.6% U.S. tax rate, even though Mr. Y has not actually received a dividend from the corporation. When the corporation earns the $50 million, it must pay $25 million of taxes to Country A. However, Mr. Y does not get a foreign tax credit for the Country A taxes that the corporation pays, although the taxes are excluded from the deemed dividend amount he receives.

Therefore, assuming that the corporation has no other deductions, Mr. Y must pay 39.6% of U.S. taxes on the deemed dividend of $25 million ($50 million minus $25 million of Country A taxes) for a total of $9.9 million in U.S. tax.

Because of his tax planning, Mr. X is able to eliminate his U.S. taxes while Mr. Y is not (even though both individuals pay the same amount of Country A tax).

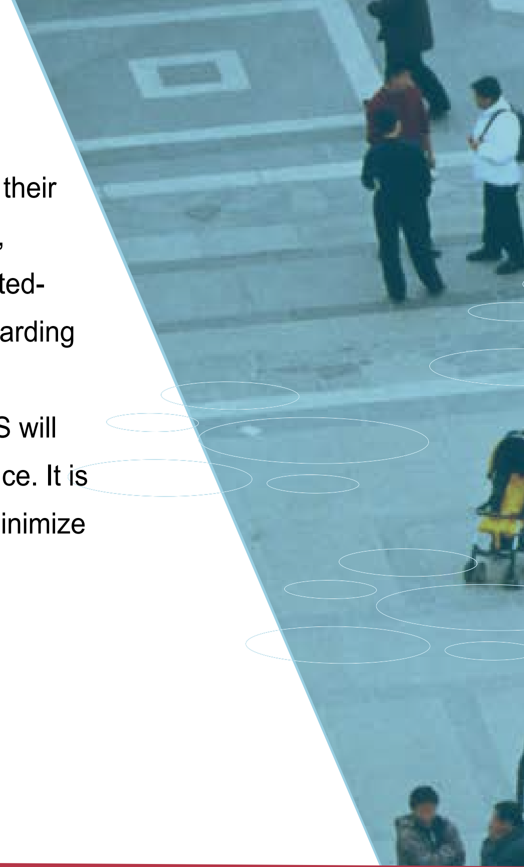
## *Qualified Dividends*

For business holdings in low-tax jurisdictions, the strategy is different. The goal is to repatriate the earnings through a qualifying treaty country so that the earnings are only taxed at the 20% rate (as opposed to the higher ordinary rates up to 35%). This is accomplished by setting up an intermediate entity in a qualifying treaty country.

## *Example*

Two individuals, Mr. X and Mr. Y, each own interests in a corporation organized in a country with which the United States does not have a qualifying income tax treaty. Each also acquires a provisional green card and desires to move to the United States. Before moving, Mr. X engages a U.S. tax advisor who sets up an intermediary entity in a qualifying treaty country. Mr. Y fails to engage in any tax planning before moving. While Mr. X and Mr. Y are in the United States, the non-treaty jurisdiction corporation issues a dividend of $1 million to each of them. Mr. X's dividend is paid to the intermediary in the qualifying treaty country, and then that entity issues a dividend to Mr. X. Mr. Y's dividend is paid to him directly from the non-treaty country corporation. Mr. X's dividend is taxed in the United States at 20%. By contrast, Mr. Y's dividend is taxed in the United States at 39.6%. Because of his tax planning, Mr. X was able to save $196,000 of taxes.

## *Transfers Between Related Parties*



Additionally, we provide U.S. tax planning advice to Chinese corporations (or their offshore affiliates) doing business in the United States, including closely-held, widely-held, and public companies investing in U.S. real estate, by using related-party debt to reduce or eliminate U.S. income taxes. One important issue regarding transactions with related parties is that any transactions with related parties, including branches and subsidiary companies, will be scrutinized, and the IRS will look at comparable uncontrolled transactions to determine the appropriate price. It is often advisable to undertake a study to support a pricing schedule so as to minimize the likelihood that the IRS will adjust that price.

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## *Example*

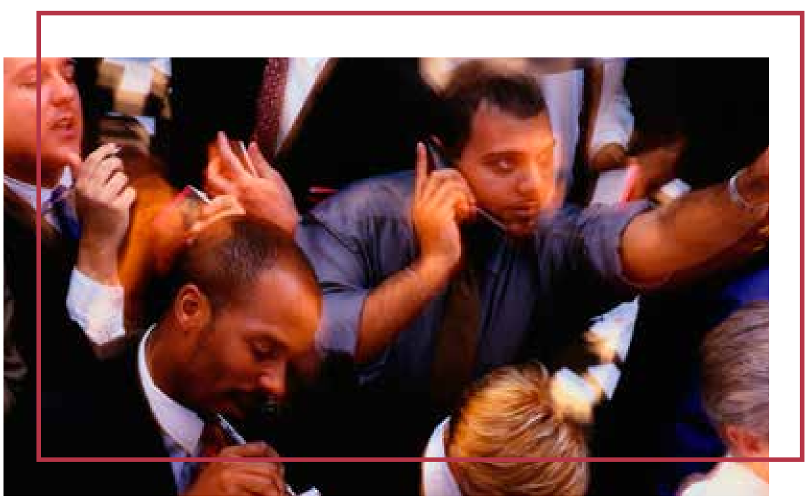
A company organized in Country A manufactures a product. That company has a subsidiary in Country B. The Country A parent company sells the product to the Country B subsidiary for $10 million. A similar product manufacturer sells similar products to unrelated parties for $30 million. The IRS will scrutinize the $10 million sales price for the sale between the parent and the subsidiary unless the companies can prove that the $10 million sales price was used in comparable transactions with unrelated parties. If the Country A parent engages a U.S. tax advisor to provide a study that can show that the $10 million sales price was a valid arms-length transaction unaffected by the relationship between the parent and the subsidiary, it may be able to avoid IRS readjustments of that price.

## *Other Business Activities*

Passive income cannot be easily deferred by holding passive assets through an offshore corporation. The United States has anti-deferral rules that treat the passive income as if it were distributed to the U.S. resident shareholder. However, with certain variable life insurance products, the income can be deferred (and even completely avoid U.S. income taxes) and, if properly structured, the potential U.S. estate tax thereon can also be avoided.

We also provide a variety of international tax planning services for Chinese nationals who have invested or wish to invest in the United States, including active U.S. businesses, U.S. real estate, U.S. situs art collections, and U.S. stock portfolios, and we focus on ways to reduce or eliminate U.S. income and estate taxes with respect thereto.

For example, certain export businesses can be designed to operate in the United States and obtain investor visas for their owners while completely avoiding U.S. income taxes on the foreign-destined sales.



## *Example*

Mr. X and Mr. Y plan to move to the United States and each obtains a provisional green card. Before moving to the United States, Mr. X engages a U.S. tax advisor who helps him irrevocably transfer all of his assets to a trust. While he is alive, Mr. X's family members (but not Mr. X himself) are the beneficiaries of the trust. Upon his death, the trust will be distributed to the persons designated by Mr. X in the trust instrument. Mr. X will pay income tax on any income earned by the trust, but all of the assets held by the trust will pass to the trust beneficiaries free of Federal Estate Tax. In contrast, Mr. Y failed to engage a U.S. tax advisor, so he owns all of his assets in his individual name. Upon his death, all of Mr. Y's assets will be subject to the Federal Estate Tax.

## *Trusts*

Finally, we help individuals set up trusts before they move to the United States. A trust is a legal structure whereby assets are held in the name of the trust rather than the name of the individual who transfers the assets to the trust. The earnings are distributed to the person(s) designated in the trust.

Trusts may be used in many different fashions. For example, trusts provide privacy by moving rights to the assets from an individual to the trust, which is an entity separate from the individual. The trust document does not get filed anywhere in the public records but, instead, stays in the possession of an attorney. The trust document does not even need to be provided to U.S. government authorities upon the death of the settlor of the trust. However, most importantly, trusts can be used to avoid paying estate taxes upon the death of an estate and gift tax resident. If an individual irrevocably transfers assets to a trust prior to moving to the United States, those assets will not be includable in that individual's estate upon his or her death.

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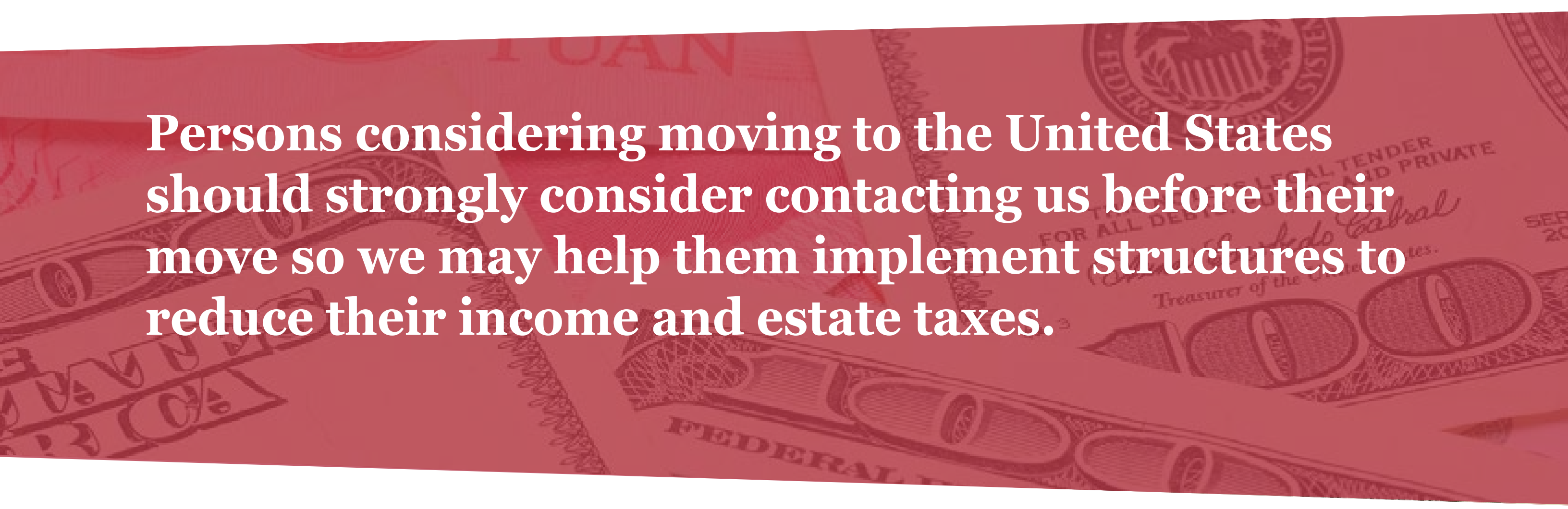
For more than 114 years, since the firm was founded in 1901, Carlton Fields has attracted lawyers who have served at the highest levels of government, the judiciary, and influential professional organizations. These leaders have included governors of the State of Florida, state senators and representatives; chief justices of the Florida Supreme Court, United States District Court, and United States Court of Appeals; and presidents of the American Bar Association and the International Bar Association.

Our attorneys' past and ongoing affiliations with these and many other institutions provide us with a wealth of insight and a strong network of personal and professional relationships. Clients benefit from working with the many Carlton Fields professionals who have previously served as judges and judicial clerks, and those who have held leadership positions with numerous government agencies. We understand the inner workings of these organizations, enabling us to effectively navigate them on behalf of our clients.

Clients with business interests or disputes throughout the United States and abroad rely on Carlton Fields. Our 370 attorneys and government consultants serve a distinguished mix of national and local corporations, state and local public entities, and individuals. We have represented many of the *Fortune* 100 companies, and most of the law firms on the *AmLaw* 100 list have referred matters to us.

Our geographic locations have contributed to our reputation with clients and within the legal community. Our strategically placed offices and deep roots throughout the country have enabled us to develop the highly specialized tax experience that these immigrants need, giving us—and our clients—an edge.



**Persons considering moving to the United States should strongly consider contacting us before their move so we may help them implement structures to reduce their income and estate taxes.**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