

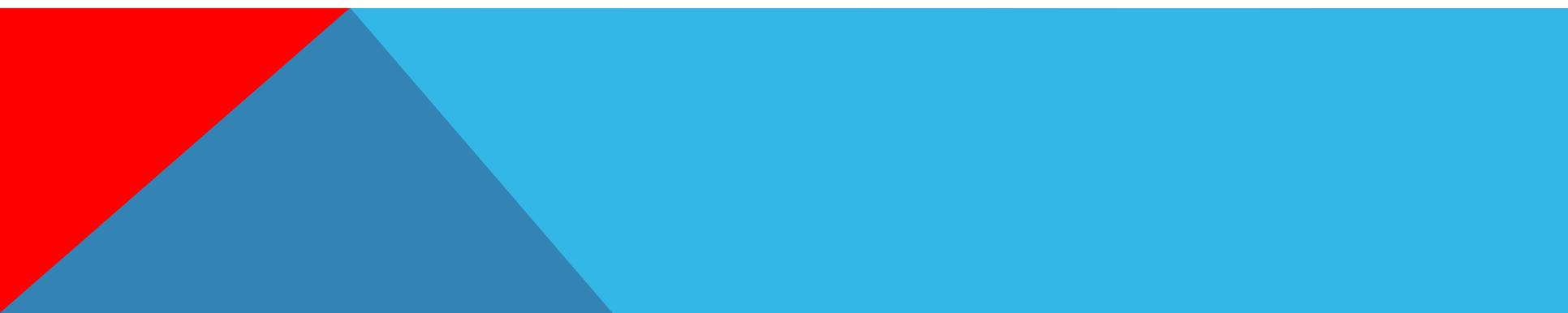
Income and Estate Tax Planning Tricks and Traps for Visa Resident and Green Card Holders

**Austin C. Carlson, Gray Reed & McGraw LLP
John Strohmeyer, Crady, Jewett & McCulley LLP**

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Agenda

- **Income and Estate Tax Residency Basics**
 - **How do treaties fit in the mix?**
 - **Confronting common client truth bombs –tricks and traps for visa residents and green card holders.**
 - **A few thoughts on tax reform and how it affects visa residents and green card holders.**
 - **Questions?**
- 

BASICS OF RESIDENCY DETERMINATIONS



INCOME TAX RESIDENTS

- U.S. Citizens
- Legal Permanent Resident (a.k.a. the “Green Card” Test)
- Substantial Presence Test
 - 31 days in the tax year in question
 - 183 days over the tax year in question and the previous two tax years
 - Days during the tax year in question fully counted
 - Days during immediately preceding tax year counted 1/3
 - Days during tax year two years before counted 1/6
- First-year election
 - Must be substantially present in the subsequent tax year

INCOME TAXATION OF NONRESIDENT ALIENS

Effectively Connected Income (“ECI”)

- Net-basis taxation for business income

Gains from the Sale of Real Property – FIRPTA

- Subject to mandatory 15% withholding, and taxed as ECI
- Certain taxpayers are subject to 10% withholding

Fixed, Determinable, Annual, or Periodical Income (“FDAP”)

- All income other than gains from sale of property or income excluded from gross income (e.g., dividends, interest, pensions and annuities, alimony, rent, and royalties)
- Gross-basis taxation subject to mandatory 30% withholding

Gains from the Sale of Non-Real Property – Not Taxed

Income Taxation of Nonresident Aliens

Dual-Status Year Returns

- No standard deduction, but may claim exemptions for spouse and dependents while a resident.
- May not file a joint return or file as Head of Household.
- If you end the year as a resident alien, file Form 1040 with a statement showing income from nonresident portion of the year.
- If you end the year as nonresident alien, file Form 1040NR with a statement showing income from resident portion of the year.

Mitigating US Income Tax

Foreign Tax Credit – Form 1116 and Form 1118

- A credit (or an itemized deduction) for taxes paid to a foreign country or U.S. possession if the same income is also subject to U.S. tax.

Foreign Earned Income Exclusion

- Up to \$104,100 of foreign earned income in 2018
- Or foreign earned income less foreign housing exclusion
- Requirements
 - Qualified Individual – either a citizen or resident alien
 - Have foreign earned income
 - Meet the Bona Fide Residence Test or the Physical Presence Test

“Tax Home” in a foreign country

Valid Election on Form 2555 or Form 2555-EZ

TRANSFER TAX RESIDENTS

Transfer Taxes are imposed on U.S. citizens and residents

- Residents are those who are domiciled and primarily residing in the U.S.A. with no definite present intention of leaving, regardless of the time actually present. Treas. Reg. §§ 20.0-1(b), 25.2501-1(b).
- Not a bright-line rule like Substantial Presence, but a facts and circumstances test
- All others are considered a “nonresident not a citizen of the United States”

U.S. TRANSFER TAXATION OF NONRESIDENTS

Estate Tax applied to property located in the U.S.A.

- Stock in U.S. corporations (whether or not publicly traded)
- Real property
- Tangible property in the U.S.A. (e.g., cash in a safe deposit box)
- Uncertain treatment of foreign partnership interests
- Revocable trusts or trusts
- \$60,000 estate-tax exemption
- Nonrecourse debt on U.S. property results in only net value included in U.S. estate

U.S. TRANSFER TAXATION OF TRANSFER TAX RESIDENTS

- Estate Tax, Gift Tax, and Generation-Skipping Transfer Tax are applied to worldwide assets.
- \$10,000,000 inflation-adjusted Unified Estate Tax and Gift Tax Exemption (\$11,200,000 per person in 2018)
- \$10,000,000 inflation-adjusted GST exemption (\$11,200,000 per person in 2018)
- Unlimited marital deduction is available for assets left to U.S.-citizen spouses.
- \$15,000 Annual Exclusion for gifts to non-spouses
- Unlimited exclusion for certain gifts for health and education

U.S. TRANSFER TAXATION OF NONRESIDENTS

Gift Tax

- No lifetime exemption
- \$15,000 Annual Exclusion for gifts to non-spouses
- \$152,000 Annual Exclusion for gifts to non-citizen spouses in 2018
- Unlimited marital deduction for gifts to citizen spouses
- Unlimited exclusions for educational and medical payments
- Donees take a carryover basis in transferred property

The GST Tax applies if the Estate & Gift Taxes apply

- \$1,000,000 GST exemption(?)

U.S. TRANSFER TAXATION OF NONRESIDENTS

Unlimited marital deduction is available for assets left to U.S.-citizen spouses.

- A “QDOT” can be established for non-citizen spouses

Charitable deduction and deduction for estate administration expenses

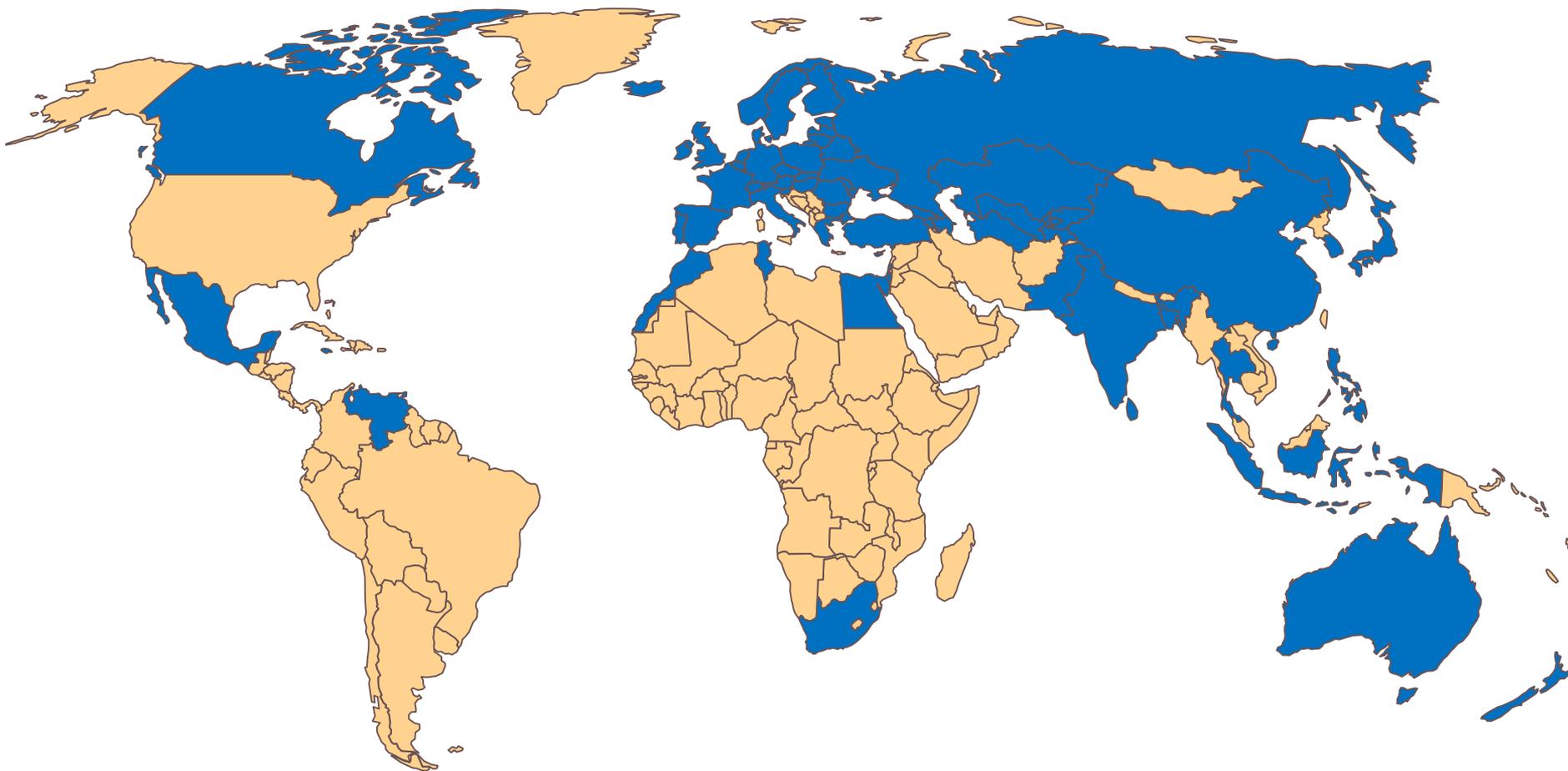
- Ratio of U.S. assets to worldwide assets

Donees take stepped-up basis in transferred property

U.S. INCOME TAX TREATY SYSTEM

- The U.S.A. is a party to 59 bilateral income tax treaties with 66 countries.
 - The U.S.-U.S.S.R income tax treaty applies to Armenia, Azerbaijan, Belarus, Georgia, Krgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.
 - The U.S.-China income tax treaty does not apply to Hong Kong.
- Four protocols amending existing treaties have been signed but not approved by the Senate.
 - Japan signed in 2013 amending the 2003 treaty
 - Luxembourg signed in 2009 amending the 1996 treaty
 - Spain signed in 2013 amending the 1990 treaty
 - Switzerland signed in 2012 amending the 1996 treaty
- Four treaties have been signed but not approved by the Senate.
 - Chile signed in 2010 (first treaty)
 - Hungary signed in 2010 replacing 1979 treaty
 - Poland signed in 2013 replacing the 1974 treaty
 - Vietnam signed in 2015 (first treaty)

U.S. INCOME TAX TREATY PARTNERS



SELECTED TREATY ARTICLES

- Article 2 – Taxes Covered
- Article 3 – General Definitions
- Article 4 – Resident
 - *Cole v. Comm'r.*, T.C. Summ. Op. 2016-22
 - *Topsnik v. Comm'r.*, 146 T.C. No. 1 (2016)
- Article 5 – Permanent Establishment
- Article 6 – Income From Real Property
- Article 7 – Business Profits
- Article 12 – Royalties
- Article 13 – Gains
- Article 15 – Directors' Fees
- Article 16 – Entertainers and Sportsmen
- Article 20 – Students and Trainees
- Article 22 – Limitation on Benefits
- Article 23 – Relief From Double Taxation
- Article 25 – Mutual Agreement Procedure

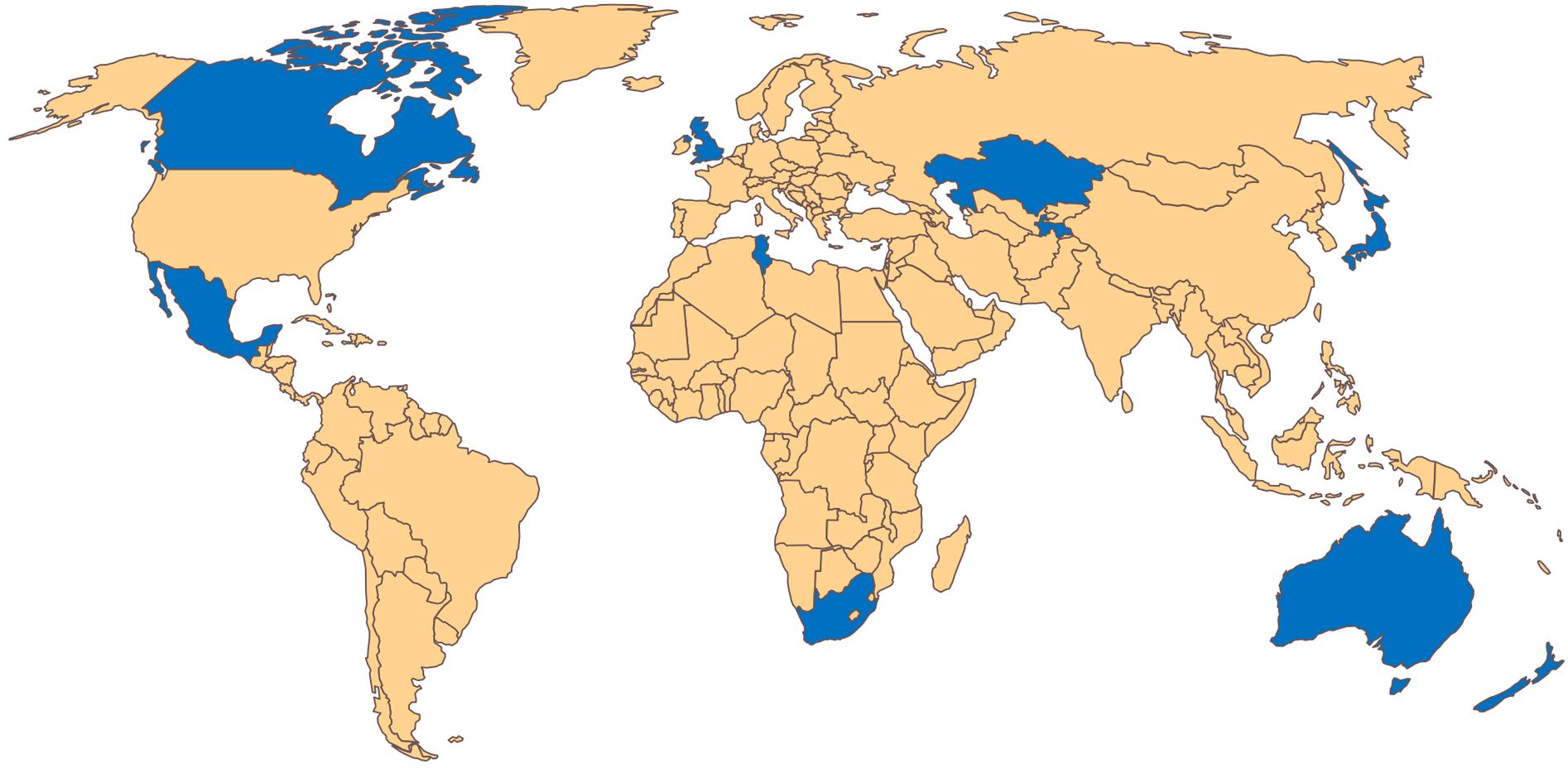
SELECTED TREATY ARTICLES

- Income tax treaties authorize exchange of information on a case-by-case basis as “may be relevant” (or “is foreseeably relevant”) to carry out treaty purposes or for administration of U.S. taxes.

TREATY COMPARISONS

- Australia (effective Dec. 1, 1983, Protocol Jan. 1, 2004)
- Canada (effective Jan. 1, 1985, Protocols Jan. 1, 1996, Dec. 16, 1997, and Jan. 1, 2009)
- Japan (effective Jan. 1, 2005)
- Kazakhstan (effective Jan. 1, 1996)
- Mexico (effective Jan. 1, 1994, Protocols Oct. 26, 1995 and Jan. 1, 2004)
- New Zealand (effective Nov. 2, 1983, Protocol Jan. 1, 2011)
- South Africa (effective Jan. 1, 1998)
- Tajikistan (U.S.-U.S.S.R. Income Tax Treaty) (effective Jan. 1, 1976)
- Tunisia (effective Jan. 1, 1990)
- United Kingdom (effective Jan. 1, 2004)

U.S. INCOME TAX TREATY COMPARISON



DIVIDENDS (ARTICLE 10)

Tax Rate on Dividends Paid by U.S. Corporations

- No Treaty – 30%
- Model Treaty – 5% if owner has 10% ownership, 15% otherwise
- Australia – 15%
- Canada – 15%
- Japan – 10%
- Kazakhstan – 10%
- Mexico – 10%
- New Zealand – 15%
- South Africa – 15%
- Tajikistan – 30%
- Tunisia – 15%
- United Kingdom – 15%

INTEREST (ARTICLE 11)

Tax Rate on Interest Income Paid by U.S. Obligor

- No Treaty – 30%
- Model Treaty – 15%
- Australia – 10%
- Canada – 0%
- Japan – 10%
- Kazakhstan – 10%
- Mexico – 15%
- New Zealand – 10%
- South Africa – 0%
- Tajikistan – 0%
- Tunisia – 15%
- United Kingdom – 0%

PROPOSED CHANGES TO U.S. MODEL TREATY

On February 17, 2016, Treasury released proposed changes to the U.S. Model Income Tax Treaty.

- New Article 1 Paragraph 7 – Exempt Permanent Establishments
- New Article 3 Paragraph 1(l) – “Special Tax Regime”
- Changes in Articles 10, 11, & 12 – Payments to Expatriated Entities
- Changes to Article 22 – Limitation on Benefits
- New Article 28 – Subsequent Changes in Law

U.S. ESTATE & GIFT TAX TREATIES



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Estate & Gift Tax Treaties (International)

English

Individuals

International Taxpayers

Businesses and Self-Employed

Small Business and Self-Employed

[Employer ID Numbers](#)

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[Self-Employed](#)

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[Closing a Business](#)

- [Estate and Gift Taxes](#)

| Country | Separate Estate | Separate Gift | Combined E & G | Other |
|-----------|-----------------|---------------|----------------|---------------|
| Australia | No | Yes | No | No |
| Australia | Yes | No | No | No |
| Austria | No | No | Yes | No |
| Belgium | Yes | No | No | No |
| Canada | No | No | No | 1995 Protocol |

ESTATE & GIFT TAX TREATIES

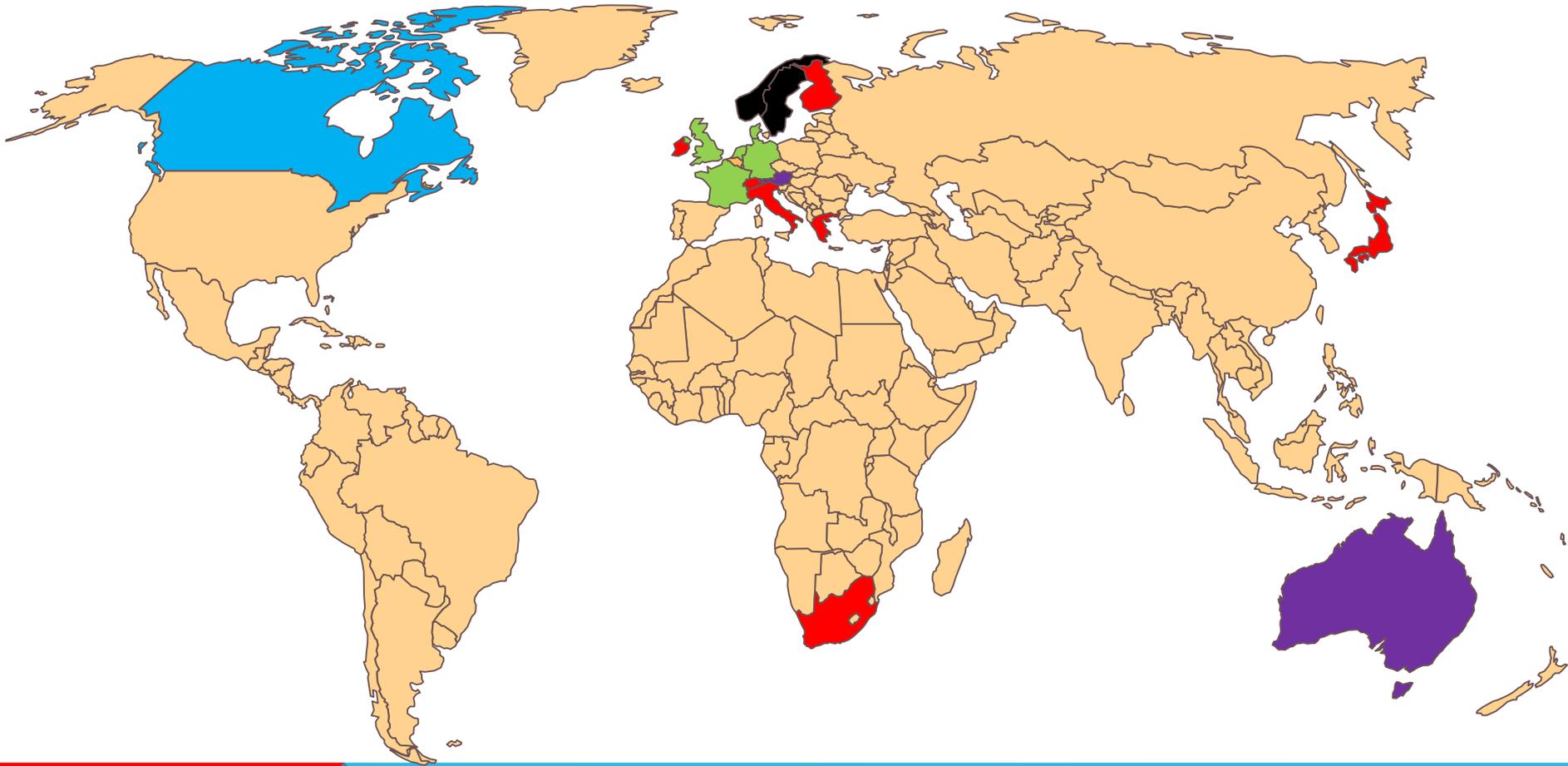
8 Situs-Type Treaties

- Allocation taxation of assets to jurisdictions based on the situs of the assets
- Estate tax treaties with Australia, Finland, Greece, Ireland, Italy, Japan, Norway, South Africa, & Switzerland

7 Domicile-Type Treaties

- Allocate taxation of assets to jurisdictions based on the domicile of the taxpayer
 - Estate tax treaties with Austria, Denmark, France, Germany, Netherlands, Sweden, & the United Kingdom
 - Protocol Amending United States-Canada Income Tax Treaty
- 

U.S. ESTATE & GIFT TAX TREATY PARTNERS



“I’m only going to be in the US for a few years, so I don’t need to do any estate planning here.”



NON-TAX ESTATE PLANNING ISSUES

- Statutory Durable Power of Attorney
 - Medical Power of Attorney
 - Declaration of Guardian for Self
 - Declaration of Guardian for Children
 - HIPAA Authorization
 - Directive to Physicians (aka “Living Will”)
 - Beneficiary designations for accounts
- 

“I’m a trustee of a US trust, but we have a few foreign beneficiaries.”



DISTRIBUTIONS TO FOREIGN BENEFICIARIES

- Generally, payments to nonresidents are subject to mandatory withholding, regardless of character.
 - Nonresidents will not file a Form 1040NR to report distributions and remit tax if withholding is sufficient.
 - Character of receipts in the hands of a trustee will determine the character in the hands of the beneficiary.
- To ensure that the US income tax is paid, trustees must report distributions on Form 1042-S and withhold tax at a rate of 30% on the gross amount of distributions to foreign beneficiaries.
 - Additional Forms 1042-S must be completed for each type of income that is not withheld at the statutory withholding rate.
 - Income exempt from withholding must be reported on Form 1042-S.
- Trustees must also file Forms 1042 and 1042-T.

DISTRIBUTIONS FROM ESTATES

- Specific bequest exception
- Separate share rule
- Interest on funding pecuniary bequests
- Distribution of property in satisfaction of pecuniary bequest
- Distribution of IRD to satisfy pecuniary bequest
- In-kind distributions are typically not taxable under Rev. Rule 69-486

BASIS REPORTING FOR ESTATE TAX

IRS FORM 8971

- Property Subject to Basis Consistency Requirement
- Property Exempt from Reporting
- Penalties for Failure to File Information Return
- Certain foreign beneficiaries don't need to obtain a TIN for Form 8971 reporting

**“I FILED A JOINT RETURN
WITH MY NON-RESIDENT
SPOUSE. ”**



Code 6013(g) Election to Treat NRA Spouse as a Resident

- * Billy is a resident alien, but his wife is a non-resident alien.
 - * They may elect to have the spouse treated for U.S. income tax purposes as a resident alien.
 - * They must file a joint tax return for the first year of the election, but may file separate returns in later years.
 - * If they elect to treat the spouse as a resident alien, neither of them may claim to be treated as a non-resident under any tax treaty.

**“I JUST RECEIVED THIS GIFT
A FAMILY MEMBER WHO
LIVES ABROAD.”**



Foreign Gifts & Code § 6039F

- * Even though the gifts are not necessarily subject to US Estate or Gift Tax, if a US person must report on Form 3520 the receipt of either of the following:
 - * More than \$100,000 from a nonresident alien individual or a foreign estate.
 - * More than \$16,111 (in 2018) from foreign corporations or foreign partnerships (including foreign persons related to such foreign corporations or foreign partnerships) that you treated as gifts.

Foreign Gifts & Code § 6039F

- * Code §6677 imposes penalties if Form 3520 is not filed. The initial penalty is equal to the greater of \$10,000 or:
 - * 35% of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the creation of or transfer to a foreign trust or
 - * 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distribution or
 - * 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person for failure by the U.S. person to report the U.S. owner information.

**“OH BY THE WAY I HAVE A
FOREIGN PENSION”**



Steps in Analysis

STEP 1: How is the plan characterized under US law?

STEP 2: What are the U.S. tax consequences to the beneficiary of such characterization?

STEP 3: Does a tax treaty modify otherwise applicable US law?

STEP 4: Tax Compliance



Foreign Pensions

□ U.S. Income Taxation of Contributions, Earnings, and/or Distributions depends on how the foreign pension plan is characterized under U.S. law.

- Qualified Plan under IRC 401(a)?
- Nonexempt employees' trust under IRC 402(b)?
- Non-Qualified Employer Pension
 - Foreign grantor trust?
 - Private Pension
 - Investment in Passive Foreign Investment Company (PFIC)

Reporting Requirements

- Informational Reporting Requirements
 - Forms 8621
 - Form 8938
 - Forms 3520/3520-A
 - FBAR

Income Tax Considerations

- Inclusion of Foreign Employer payments in U.S. taxable income

- Taxation and Reporting on Sale



**“I GOT A HOT TIP ON SOME
FOREIGN MUTUAL FUNDS
AND BOUGHT AND SOLD
SOME LAST YEAR”**



PFICs

Passive Foreign Investment Companies

- Most common culprit are foreign mutual funds.
- If held in an investment account, reportable as one asset on the FBAR
- However, each PFIC must be separately reported on Forms 8621
- Distributions must be reported **EVEN IF REINVESTED**

PFICs

Failure to file Form 8621 for any year it is required:

- No monetary penalty
- Leaves the SOL open for the entire tax return

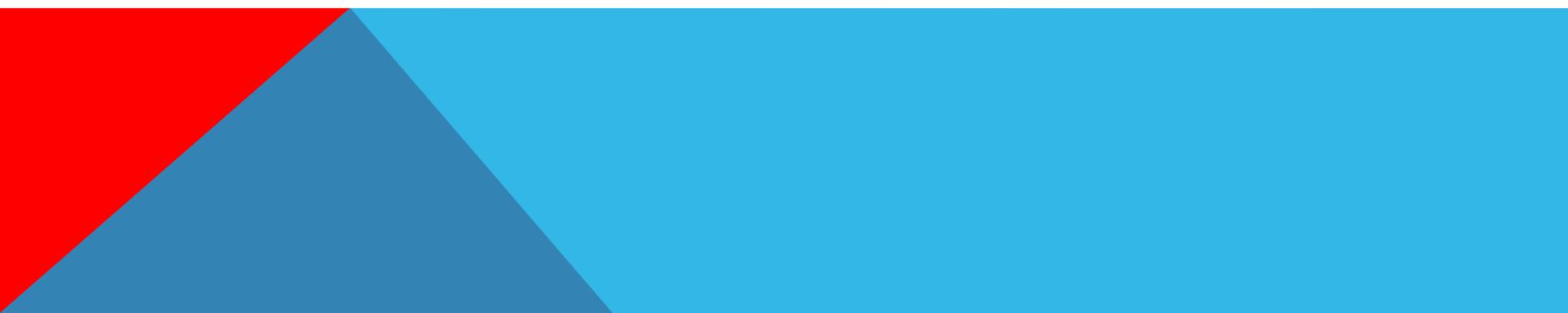
§6501(c)(8)(A)

- If also missed on FBAR or Form 8938 - potential for \$10,000 penalties

Form 8621 must be filed-even if a tax return is not required

PFICs

Planning

- Prior to becoming resident, may want to sell PFICs to avoid taxation
 - If going to be a non-resident in the future, may want to wait to sell PFIC (but consider exit tax)
 - Mark to Market Election
- 

**“I JUST FOUND OUT MY
PARENTS HAVE HAD
ACCOUNTS IN MY NAME
FOR YEARS”**



FBAR/Form 8938 Reporting Basics

All U.S. persons must report foreign accounts on an FBAR is greater than \$10,000 in the aggregate.

Form 8938 has higher thresholds.

What if a person doesn't have a financial interest in the account?



Nominee Rules -- FBAR

Financial Interest. A United States person has a financial interest in a foreign financial account for which:

1. the United States person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the United States person or for the benefit of another person; or
2. the owner of record or holder of legal title is one of the following:
 - a. An agent, nominee, attorney, or a person acting in some other capacity on behalf of the United States person with respect to the account;

Nominee Rules – FBAR

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Signature Authority. Signature authority is the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account. See Exceptions, Signature Authority.

Nominee Rules – Form 8938

Interests in Specified Foreign Financial Assets

You have an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the asset are or would be required to be reported, included, or otherwise reflected on your income tax return.

Corrective Actions

- Consider Delinquent FBAR Submission Procedures
- Consider entering into formal Nominee Agreements



**“I GOT MY GREEN CARD 9
YEARS AGO, IS THAT A
PROBLEM FOR THE EXIT
TAX”**



Long Term Resident

- A person is a long-term resident if they are a U.S. tax resident for any 8 of the last 15 years.

There are two ways a “lawful permanent resident” ceases to have that status:

The individual abandons the green card [see Internal Revenue Code Section 7701(b)(6)(A) and (B)]; or

The individual makes an election under a relevant income tax treaty to be taxed as a nonresident of the United States and a resident of another country instead (see Internal Revenue Code Section 7701(b)(6)).



Example

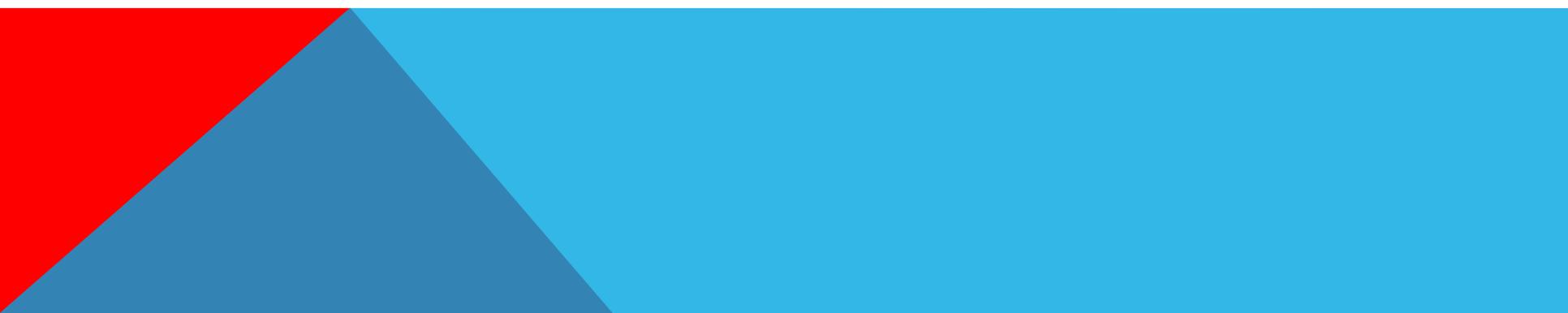
John is a French citizen and has had his green card since October 8, 2010. It's now January 9, 2018 and John is concerned he is too late for escaping the exit tax on giving up his green card.

What can you do?



Example

Counting the years:

1. If you are a green card holder for one day in a calendar year, you are a lawful permanent resident for that year.
 2. That would mean if he gave up his green card via immigration paperwork, he would be at 9 years!
 3. However, you don't count years you make an election to be a non-U.S. tax resident.
 4. Make election with 2017 tax return.
 5. Expatriation is deemed to happen as of December 31, 2016.
- 

**Being a US taxpayer has been
really great, but . . .**



EXPATRIATION

U.S. citizens and long-term U.S. residents who cease to be permanent U.S. residents may be “Covered Expatriates.”

Three-prong test to not be a Covered Expatriate

- Average annual net income tax bill for the five prior years ending before expatriation under \$165,000 in 2018 (adjusted for inflation)
 - Net worth under \$2,000,000 on date of expatriation (not adjusted for inflation)
 - Certify on Form 8854 that you’ve complied with all U.S. federal tax filing obligations for 5 years preceding date of expatriation
- 

EXPATRIATION

Income tax on mark-to-market valuation of assets on the day before expatriation (\$713,000 exemption in 2018)

Must report for 10 years.

- *Topsnik v. Comm'r.*, 143 T.C. No. 12 (2014) –
 - If you fail to properly exit the US tax system, then you haven't left the U.S. tax system.
- Special rules apply to distributions from applies only to nongrantor trusts only if the covered expatriate was a beneficiary of the trust on the day before the expatriation date.

NONGRANTOR TRUSTS AFTER EXPATRIATION

The “taxable portion” of a distribution is that portion of the distribution that would be includible in the gross income of the covered expatriate if such expatriate continued to be subject to tax as a citizen or resident of the United States.

A “nongrantor trust” means the portion of any trust that the individual is not considered the owner of under subpart E of part I of subchapter J, with the determination made immediately before the expatriation date.



NONGRANTOR TRUSTS AFTER EXPATRIATION

Special Rules apply to withholding

- Any item subject to the withholding is subject to tax under Code § 871.
- Any item subject to withholding is subject to withholding under Code § 1441.
- Rules similar to the rules for withholding liability under Code §§ 1461 – 1464.

Treaty Issues: The covered expatriate is treated as having waived any right to claim any reduction under any treaty with the United States.

Our New Inheritance Tax

Code § 2801 imposes a 40% inheritance-style tax on transfers from Covered Expatriates to Estate & Gift Tax Residents.

The annual exclusion applies, but the medical and education exemptions don't apply.

The tax is not imposed if the transferor files Form 706 or 709.

This will not be imposed until the Treasury Regulations have been finalized.

Example: \$50,000 gift for tuition paid directly to the institution

- **After the \$15,000 annual exclusion, \$35,000 remains subject to tax.**
- **$40\% \times \$35,000 = \$14,000$ tax that the recipient, not the donor, pays.**

**“WASN’T THERE A TAX BILL
RECENTLY?”**



An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (“AAPRTIIVCRBFY” or “the 2017 Tax Reform Act”).

- Foreign Tax Credit Changes
 - New modified territorial system for corporations
 - Subpart F Inclusion For Global Intangible Low-taxed Income
 - Base Erosion and Profit-Shifting (BEPS) provisions
 - Passive Foreign Investment Company changes
 - Interest expense apportionment
 - Stock Compensation of Insiders in Expatriated Corporations
- 

Income Tax Considerations

- Personal exemptions going away, but child tax credit will require SSN (used to be ITIN or SSN)

Transition Treatment of Deferred Foreign Income to Participation Exemption System:

U.S. shareholders (with 10% ownership of a foreign corporation and for a foreign corporation tax year beginning before 2018) must include in income the U.S. shareholder's pro rata share of the net post-1986 historical not previously taxed earnings and profits (E&P). The E&P is taxed at a reduced rate of 15.5% for E&P comprised of cash or cash equivalents. All other E&P is taxed at 8%. Election to pay tax liability over a period up to eight years (payments for year 1-5 is 8% of tax liability, year 6 to be at 15%, year 7 to be at 20% with year 8 at remaining balance of 25%). Special rules are allowed for S corporations. The shareholders can elect to maintain deferral of foreign income until the S corporation changes its status, sells all its assets, liquidates or ceases business.

New Rules for Passive and Mobile Income – Global Intangible Low-Tax Income (GILTI)

- For tax years of foreign corporations after 12/31/2017, U.S. shareholders of any controlled foreign corporation will have to include in gross income its global intangible low-taxed income (GILTI) similar to inclusions for Subpart F income. GILTI is taxed at a rate of 10% with allowable foreign tax credits (limited to 80% of foreign income taxes paid with no carrybacks or carryforwards).

CFCs

- Revisions to Controlled Foreign Corporation (CFC) Attribution Rules – For the last tax year of a foreign corporation that begins before January 1, 2018, the TCJA amends the constructive ownership rules so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for the purpose of determining CFC status.
- Addition to Definition of a U.S. Shareholder for CFC – for the last tax year of a foreign corporation that begins before January 1, 2018, the TCJA expands the definition of a US shareholder to include any U.S. person who owns 10% or more of the total value of all classes of the stock of a foreign corporation.
- Change the 30-Day Holding Period for CFC for Subpart F Inclusion – for the tax years of foreign corporations that begin after December 31, 2017, the TCJA eliminates the 30 days or more requirements for Subpart F inclusion application. Now Subpart F is applicable to any number of days of holding CFC stocks.

Estate Tax Considerations

- **More incentive to be a U.S. domiciliary?**
- **What about impact on current gifts?**

