

PART OF THE LEHMAN TAX LAW
KNOWLEDGE BASE SERIES
"United States Taxation Of Investors"

Pre-Immigration Income Tax Planning

By
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Richard S. Lehman *Esq.*

- *Masters in Tax Law from New York University Law School*
- *U.S. Tax Court and Internal Revenue Service experience in Washington D.C.*

Richard Lehman regularly works with law firms, accountants, businesses and individuals struggling to find their way through the complexities of the US tax law. *In short, Lehman is a valuable resource to each of these audiences.*

With over 38 years as a tax lawyer in Florida, Lehman has built a national reputation for being able to handle the toughest tax cases, structure the most sophisticated income tax and estate tax plans, and defend clients before the IRS.

- Mr. Lehman's international practice spans the globe. This has resulted in Lehman's representation of foreign investors giving tax and practical advice in acquiring and selling a wide range of commercial businesses and other U.S. investment assets. This includes not only the acquisition and sale of active businesses in the U.S. but also investments in all fields of real estate including raw land, shopping centers, commercial office buildings, condominiums, residential apartments, residential homes and the like.

Definition for Tax Purposes

Non Resident Alien vs Resident Alien

The Resident Alien

- Taxation on Worldwide Income Similar to Taxation on U.S. Citizens
- Tax Planning

TAXATION PATTERN

U.S. Resident Alien ("Tax Resident") - Subject to Taxation

1. Income Taxation - Worldwide Income
2. Estate Taxation - Worldwide Assets
3. Gift Taxation - Worldwide Assets

STATUS FOR TAX PURPOSES

Non-Resident Alien - Not a “Resident Alien”

Resident for Income Tax Purposes

1. Green Card
2. Substantial Presence Test
3. Voluntary Election

Exceptions:

4. The Closer Connection
5. Treaties: Tie Breaker

Foreign Corporations

The Closer Connection Exception

**Exception
where individual
is present in the
United States
during less than
one-half of
current year and
closer connection
to foreign country
is established.**

An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current year if . . .

- (i) such individual is present in the United States on fewer than 183 days during the current year, and
- (ii) it is established that for the current year such individual has a tax home (as defined in section 911(d)(3) without regard to the second sentence thereof) in a foreign country and has a closer connection to such foreign country than to the United States.

Tax Treaty - Tie Breaker Rules

For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of incorporation, or any other criterion of a similar nature.

- *However*, this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. In the case of income derived by a partnership, trust, or estate, residence is determined in accordance with the residence of the person liable to tax with respect to such income.

Tax Treaty - Tie Breaker Rules

Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) He shall be deemed to be a resident 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, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
- (b) If the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a citizen;
- (d) If each State considers him as its citizen or if he is a citizen of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

EXCEPTIONAL CIRCUMSTANCES AND SPECIAL BENEFITS

Students

A foreign student who has obtained the proper immigration status will be **exempt** from being treated as a U.S. resident for U.S. tax purposes even if he or she is here for a substantial time period that would originally result in the student being taxed as a U.S. resident.

This student visa not only permits the student to study in the United States, but to pay taxes only on income from U.S. sources not worldwide income.

The visa also permits the student's direct relatives to accompany the student to the United States and receive the same tax benefits.

Residency Starting Date

Substantial Presence Test

Residency starting date for individuals meeting substantial presence test. In the case of an individual who meets the substantial presence test of paragraph (3) with respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

Substantial Presence Test

NON RESIDENT ALIEN			RESIDENT ALIEN		
Residency “Days”	Days in US	Year	Formula	Days in US	Residency “Days”
120	120	2010	100%	120	120
40	120	2009	33.33%	150	50
20	120	2008	16.67%	120	20
180	Total			Total	190

Resident Alien

Tax Residency in the United States

1. The Affect of Treaties
2. The Substantial Presence Test
3. The Closer connection Exception
4. Additional Exceptions

Residency Starting Date

Green Card

Residency starting date for individuals lawfully admitted for permanent residence. In the case of an individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test of paragraph (3), the residency starting date shall be the first day in such calendar year on which he was present in the United States while a lawful permanent resident of the United States.

A dark wood desk with a blue pen and a glass of water. The text is overlaid on the desk surface.

The Residency Starting Date

*** THE IMPORTANT DATE ***

**Pre-Immigration Tax Planning
generally cannot be accomplished
after the Residency Starting Date.**

A dark wood desk with a blue pen and a glass of water. The text "Four Tax Planning Principles" is centered on the desk.

Four Tax Planning Principles

Four Tax Planning Principles

1. A Nonresident Alien, prior to becoming a U.S. tax resident will want to make sure that he or she does not have to pay a U.S. tax on gains that have accrued as a practical matter before their residency period. The first strategy is to accelerate (realize and recognize) any and all gains earned by the Taxpayer prior to becoming a Resident Alien.
2. The second key strategy is to accelerate income that is expected to be paid after residency. Income payments should be collected prior to residency to avoid being taxed by the U.S.

Four Tax Planning Principles

3. The third strategy is to defer recognizing a loss until after obtaining tax residency as a Resident Alien so that the loss can be used against post residency gains. Assets with a fair market value below cost can be sold after residency. Those losses may be taken against gains in assets earned after U.S. residency. These losses can reduce or wipe out gains from the sale of assets that accrue after U.S. residency.
4. The fourth strategy is to defer paying deductible expenses until after the Residency Starting date. Many types of payments (both business and personal) in the U.S. are deductible from a U.S. Taxpayer's income to determine the actual taxable amount of income.

Accelerate Gains Prior to Residency Starting Date

Assume a nonresident alien owned \$1.0 Million Dollars worth of shares of General Motors that was purchased for \$50,000. If the shares are sold after U.S. tax residency is assumed when the immigrant is a Resident Alien, there will be a tax on \$950,000 in gains. A sale of these same shares by a Nonresident Alien before becoming a Resident Alien would result in no taxable gain.

Accelerate Income Prior to Residency Starting Date

For example, assume a non resident alien owns a foreign corporation that conducted a business in his home country that now has \$2 Million in receivables that will not be collected until after the owner has become a Resident Alien for U.S. tax purposes.

These receivables might be accelerated, for example, by the liquidation of the taxpayer's company and the transfer of the receivables to the taxpayer at their present fair market value, prior to the **Residency Starting Date**.

The taxpayer may also sell his interest in the company or to the company for a Promissory Note. The ongoing foreign company may collect the receivables which are then paid to the seller and Non Resident Alien, in payment of the Promissory Note he received to sell his shares to the company.

Income Assets to Accelerate

- Pension Plans
- Stock Options
- Prepaid Rent
- Repaid Royalties
- Prepaid Dividends
- Prepaid Interest
- Annuity Products

Example of Sale at Loss

- Assume a non resident alien taxpayer from Panama has purchased a Panama apartment at the high end of the market for \$4.0 Million, and it is worth \$3.0 Million before he immigrates to the United States.
- Assume the Panamanian taxpayer will be immigrating to the U.S. effective January 1, 2011.
- Assume that same taxpayer invests \$100,000 in a Florida corporation after obtaining tax residency and sells the Florida corporation after obtaining Resident Alien status for \$1 Million in excess of its cost to the Panamanian investor.

Example of Sale at Loss

- In the event the investor were to sell his Panama apartment at a loss prior to becoming a Resident Alien and then sell his profitable Florida corporation at a gain in the following year when he is a Resident Alien, there will be a capital gains tax on the \$1.0 Million gain at a cost of \$150,000.
 - Had the Panama apartment been sold in the year of Residency there would be no tax cost at all since as a Resident Alien, the taxpayer would pay a tax on all of his worldwide net losses and gains, thereby reducing his U.S. gains by his Panama losses.

Estate Tax

Definition of Residency

A “resident” decedent is a decedent who, at the time of his death, had his domicile in the United States. The term “United States”, as used in the estate tax regulations, includes only the States and the District of Columbia. The term also includes the Territories of Alaska and Hawaii prior to their admission as States. See section 7701(a)(9). 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.

Defer Recognizing Loss

- In today's times there are many wealthy immigrants coming to the U.S. who have significant losses in their investment portfolios from the last few years. If it is economic, these portfolios should not be liquidated and losses should not be realized and recognized prior to immigration to the U.S.; as they can be extremely valuable to use against capital gains in the U.S.; and even against ordinary income in the U.S. under certain circumstances.
 - Assume the same taxpayer who bought General Motors stock in the prior example purchased the stock at \$1,000 and now it was only worth \$500.
 - In the event the investor were to sell his stock at a loss prior to becoming a Resident Alien, the loss is useless against other income. Had the General Motors stock been sold in the year of Residency there would be a tax loss since as a Resident Alien, the taxpayer would pay a tax on all of his worldwide net losses and gains.

The Income Tax Residency

Starting Date

1. Substantial Presence Test
2. Permanent Residency Test
3. Tax Election

Residency Starting Date

Tax Year	Days in United States	Visa Status	United States Tax Resident
2008	0	B	No
2009	12	B	No
2010	170	B	No
2011	365	L	No
2012	365	GREEN CARD	Yes

Residency Starting Date

Assumption No. 1:

The alien individual (Non Resident Alien) has no physical presence in the U.S. for the years 2007 and 2008

Assumption No. 2:

The Non Resident Alien had the following U.S. physical presence in the year 2009.

- January 1, 2009 - February 15, 2009 = **46 days**
- August 1, 2009 - December 31, 2009 = **153 days**

Total Days in U.S. = 199 days

- Green Card Issued: August 1, 2009
- With Presence in U.S. August 1, 2009
- Tax Status: U.S. Tax Resident starting January 1, 2009

Residency Starting Date

Assumption No. 1:

The alien individual (Non Resident Alien) has no physical presence in the U.S. for the years 2007 and 2008

ALTERNATIVE Assumption No. 2:

The Non Resident Alien had the following U.S. physical presence in the year 2009.

- January 1, 2009 - February 15, 2009 = **46 days**
- August 31, 2009 - December 31, 2009 = **123 days**

Total Days in U.S. = 169 days

- Green Card Issued: August 31, 2009
- With Presence in U.S. August 31, 2009
- Tax Status: U.S. Tax Resident starting August 31, 2009

The Income Tax Objectives

- A. Acceleration of Gains - Non U.S. Property
- B. Acceleration of Income from Foreign Sources
- C. Deferral of Loss Recognition
- D. Deferral of Payment of Deductible Expenses

Practical Advice

One client leads to another.

If you do the right job as a professional, it works.

If you do not, it does not work.

- Real Estate Attorney
- Tax Attorney
- Accountant
- Real Estate Broker(s)
- Appraisers

Any missing link spells the end if it is early in the relationship. A deal gone bad in Florida for someone who needs to fly in from New York for a day to fix it is a lot different than a deal gone bad for a person who comes from Mumbai.

A dark wood desk with a blue pen and a glass of water. The pen is in the bottom left corner, and the glass is in the top right corner. The wood grain is visible throughout the background.

Pre-Immigration Q&A

With Richard S. Lehman, Esq.
TAX ATTORNEY

RESIDENCY vs NON RESIDENCY

RESIDENT	TAX STATUS	NON RESIDENT
<p><i>Domiciled in U.S.</i></p> <ul style="list-style-type: none">✓ Election✓ Green Card✓ Substantial Presence Test <p><i>Exclusions</i></p> <ul style="list-style-type: none">✓ Treaty✓ Closer Connection✓ Certain VISAs	<p>Estate</p> <p>Income</p>	<p>Not Domiciled in the U.S.</p> <p>Not a Resident for U.S. tax purposes</p>

Taxable Amount & Rate

RESIDENT	TAX STATUS	NON RESIDENT
<p>Estate Tax</p> <p>\$5,000,000</p> <p>35%</p>	<p>TAXABLE AMOUNT AND RATE</p> <p>Exclusion Amount</p> <p>Tax Rate</p>	<p>Estate Tax</p> <p>\$60,000</p> <p>35%</p>
<p>Income Tax</p> <p>All taxed on net taxable income graduated rates to 35% and capital gains rates at 15% and dividends at 15%</p>	<p>ENGAGED IN BUSINESS</p> <p>Ordinary Income, Wages Interest, Dividends, Capital Gains</p>	<p>Income Tax</p> <p>All taxed on net taxable income graduated rates to 35% and capital gains rates at 15% and dividends at 15%</p>

Passive Investor

RESIDENT	TAX STATUS	NON RESIDENT
<p>All taxed on net taxable income graduated rates to 35% and capital gains rates at 15% and dividends at 15%</p>	<p>PASSIVE INVESTOR</p> <p>Tax Rate Ordinary Income and Interest (Gross) Tax Rate Capital Gains (Gross) Tax Rate Dividends (Gross)</p>	<p>30% Tax 0% Tax 30% Tax ^{1/}</p>

^{1/}Except gains from real estate.

TAX PLANNING – Joint Return Election

1995

Expatriated
Became
Nonresident Alien
July 1, 1995

10 Years must pay
Tax on Gains from
U.S. Source Income

American Wife

2000

Sale of Canadian Stock
Loss of \$1.5 Million

Sale of U.S. Stock
Gain \$1.5 Million

No Right as Non
Resident Alien to
Use Foreign Capital Loss
Against U.S. Capital Gains

Potential U.S. Tax
At 20% Capital gains
Rate \$300,000

SOLUTION:
Joint Return
Elected with
American Wife for
One (1) year only.
Canadian stock
loss offset against
U.S. stock gain.
Taxes Paid: 0

U.S. Tax Resident-Post Immigration Continued Ownership Foreign Businesses

First Level
Total Tax

**TAX
DEFERRAL**

100% Owner	100% Owner	100% Owner
Country <i>X Corporation</i>	U.S. LLC	U.S. LLC
Net Taxable Income \$200,000	Net Taxable Income \$100,000	Net Taxable Income \$300,000
Tax 10% Corporate Tax Rate	U.S. Income Tax Rate	U.S. Income Tax Rate
[\$20,000] +	[\$21,800]	[\$84,100]
[\$180,000]		

Second Level Total Tax

15% Dividend
Tax (\$180,000)

Total Tax Effect

Taxes Paid

[\$27,000]

\$20,000
\$21,000
\$27,000

\$68,800

0

0

\$84,100

Pre-Immigration Income Tax Planning



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