Tax and Succession Planning for Immigration to the United States

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Concerns Upon Moving to US

- Minimizing US *income* tax
- Minimizing US *estate* tax
- Managing State law considerations
- Balance “Home Country” Planning Needs
- Providing flexible strategy for departing the US if circumstances change
General Background & Typical Planning

Issues to Consider
Income Tax in the United States: Residents and Non-Residents

- US citizens and residents are subject to US tax on a worldwide basis
- Non-US people are subject to US tax on (i) US source income or (ii) income connected to a business in the US
- Absent treaty considerations (which should not be ignored), US residency for income tax is established when:
  - Permanent resident card obtained (“Green-Card”)
  - Substantial presence test met (generally 183 days in US measured over 3 year period)
    - Day Count Test – Average of 121 days over current and 2 prior years
  - Election to be treated as “US person”
- Income tax “residency” does not equate to estate tax “residency”
- Estate tax residency is based on domicile of individual
  - Domicile is physical presence plus an intent to remain
  - Subjective and objective factors
Progressive rates on income
- Maximum federal rate on income is 39.6% plus 3.8% surcharge
- State rates vary depending upon residence of taxpayer or State from which income is derived

Tax on Worldwide Income
- Certain income deemed earned, including income earned in certain non-US structures and life insurance policies
- Adverse tax rates apply in case of income/assets held within structures deemed “deferral devices” including so-called “passive foreign investment companies”, “controlled foreign corporations” and “foreign non-grantor trusts”
Estate Tax for Non-US Persons

- US citizens and non-US citizens domiciled in the US are subject to US federal estate tax (upon death) and gift tax (upon lifetime transfer) on worldwide assets

- Non-resident/non-US citizen persons are subject to US federal estate tax (upon death) and gift tax (upon lifetime transfer) for “US Situs” assets

- Current rate of estate tax for non-US persons is 40% with a $60,000 exemption amount (potentially adjusted by treaty) from “gross estate”
  - Japan-US Treaty increases exemption to a percentage greater amount -- $5.25MM times the percentage of assets in the US relative to worldwide assets of the Japanese resident against whom US estate tax is assessed.
  - To claim treaty benefit, a tax return must be filed
Non-US Situs Property

- Non-US situs property includes:
  - Non-US real estate
  - Non-US corporate shares
  - Tangible Property located outside of US (including certain works of art located within the US at death)
  - Bank deposits (including those located in US)
  - Debt obligations issued by non-US persons
  - “Intangible personal property the written evidence of which is not treated as being the property itself, if it is not issued by or enforceable against a resident of the United States or a domestic corporation or governmental unit”
  - Life insurance proceeds on life of Non-US person
“US Situs” Property

- “US situs” property includes:
  - Real property located in the US and tangible property located in the US (except certain works of art on loan for exhibition)
  - Shares of stock issued by a US corporation, regardless of where the certificates are physically located
    - **NOTE** that gifts of shares of stock of US corporations are free from gift tax (but not estate tax)
  - Debt obligations issued by US persons (including US governmental agencies), except for: (a) “Portfolio Debt” Obligations; & (b) Certain short-term debt obligations
  - Deposits in US banks that generate interest income *effectively connected with a US trade or business*
  - Assets owned in trust where (a) trust is considered includible in taxpayer’s gross estate for US estate tax purposes (e.g., revocable trusts) and (b) assets contributed to trust were originally US situs – i.e., assets tainted by “tracing”
Treaty Considerations

- Tax treaties may determine status of person as “resident” for both income and estate tax purposes and must be reviewed in planning.
- E.g., United States and Japan have both:
  - Income Tax Treaty spelling out alternative tests for income tax residency and allocation of income and credits.
  - Estate & Gift Tax Treaty spelling out application of US estate tax and Japanese gift/inheritance tax, including situs of assets and use of credits.
Let’s Not Forget Home Country Issues

- Internationally mobile family are likely to have home country assets and income as well as family to consider
- Basic planning must be holistic
  - cross border
  - balance home country issues/risks against US planning opportunities
- Structures must integrate across borders
Objective is to minimize income (including capital gains) once a “resident” of the United States. Strategies include:

- **Accelerate Salary/Services Income**: Request payment of any income to be made before obtaining residency – such as salary income, accounts receivable, distributions from deferred compensation plans, dividends, interest, rent, partnership distributions, sell assets, etc.

- **“Step-Up” Basis**: Cause the realization of gain in capital assets before residency – such as buying and reacquiring assets to get a basis adjustment, utilize US tax elections to cause tax liquidations of companies to obtain a basis step-up in the underlying assets, exercise stock options, accelerate payments on installment notes, sell illiquid assets to related parties, etc.
Key strategy is to minimize assets in one’s estate prior to obtaining estate tax residency in the United States:

- **Gift to Non-US Family:** Even non-US people are subject to gift tax on the transfer of *US* situs assets, thus any gifting that is appropriate of *non-US* situs assets to non-US family members should be done prior to residency (gifting to US family members simply passes the problem to them)

- **Gift to Trust:** Assets held in properly drafted trusts are not includable in the “gross estate” of a US estate tax resident. While transfers to such a trust are “gifts”, if such transfers are of non-US situs assets made prior to obtaining residency then no gift tax and such assets are outside estate of immigrant

- **US Situs Assets:** As these assets cannot be transferred without gift tax, one may contribute to a foreign corporation, then transfer the shares of the foreign corporation (to either trust or non-US family) as such stock is a non-US situs asset
Estate Tax Proof Trust

- Assets transferred to a trust may be “outside” of the “gross estate” of a settlor if properly drafted

- Generally:
  - The settlor may not, but the settlor’s family may, be a beneficiary;
  - The settlor may not, but the settlor’s family may, enjoy the use of the trust property;
  - The settlor may not act as trustee; settlor’s family may with certain restrictions;
  - The settlor may not maintain control over the disposition of the trust assets or income;
  - Trust must be irrevocable.

- Thus, must maintain some assets within “gross estate” to live on

- Notwithstanding estate tax conclusion, income within trust remains taxable to settlor (if residency obtained within 5 years of transfer)
Typical Structure: For Illustration Purposes Only

- **Settlor**
  - Transfers assets prior to US residency; not includible in "gross estate"
  - Settlor's wife and descendants as beneficiaries

- **Will**
  - Specific gifts made at death; remainder pours into trust

- **Revocable Trust**
  - Transfers assets; remains trustee and beneficiary; all assets includible in "gross estate"
  - Living expense account
  - Cars
  - Jewelry
  - Personal effects
  - Otherwise low value assets

- **Estate Tax Proof Trust**
  - Cayman or BVI "Check-the-box" election provides basis "step-up" in underlying assets and avoids anti-tax-deferral regime once residency is obtained

- **Non-US Situs Assets**

- **US Situs Assets**
Each State in the United States has probate laws and other laws concerning health care decisions, powers of attorney, etc.

Upon death, such laws dictate who succeeds to one’s assets if not otherwise planned for, e.g., husband’s assets may all transfer to wife or kids *per stirpes*

Once in the United States, and notwithstanding proper pre-immigration trust planning, one should have documents prepared to deal with these issues
Non-Tax Probate Planning con’t

- **Will**: Instructs final wishes for passing of property upon death; must be “probated” which means court must approve;
- **Revocable Trust**: Instructs final wishes of passing of assets held in the trust; no probate; more efficient;
- **Living Will**: Instructs whether one wishes to remain on life-support;
- **Durable Health Care Power**: Gives one power to make health care decision in case of another’s incapacity; and
- **Durable Property Power**: Gives one power to deal with affairs in event of another’s incapacity, such as, bank accounts, etc.
Japanese Resident Considering Move to US

What Are The Options
Assumptions

- Has been traveling to US for work over the past few years and considering substantial move to the US – possibly to Hawaii where he has been building a home
- Has US beneficiary children and Japanese resident children
- If relocate to US, Client, his wife and one child would do so; has daughter already in US (who holds passport), leaving one son in Japan
- Holds interests in a Delaware limited partnership which holds vested and unvested options to acquire shares in US-listed company for which he is employed
- Visa options include “investor visa” and application for green card – i.e., permanent residency
Green Card: Valuable Asset or Tax Trap?

- Green card holders are free to live and work in the US
- US Residents are subject to tax on worldwide income in manner similar to citizens
  - Anti-deferral tax regimes apply to “passive foreign investment companies” and foreign trusts as well as host of other complex issues
- Green Card holders are considered “resident” in US, despite lack of “substantial presence” in US – i.e., worldwide tax applies even though live in another country
  - Importantly, there are planning possibilities for Green Card holders to be considered non-residents of US under treaties, including US-Japan Treaty. Absent planning, worldwide tax applies. May be viable alternative for Client.
“Long-term” Green Card Holders are subject to “expatriation” regime of IRC Sections 877A & 2801

- Deemed sale of assets upon relinquishment of green card
- Inheritance tax to US citizen children when receive gifts from former green card holder

Planning possibilities exist for internationally mobile families to mitigate risks but planning must be undertaken

Estate tax issues to be considered as well

- Holders of Green Cards more likely considered “domiciled” in US, despite intention to retire elsewhere.
Planning for Client Considering US Move

- Even with a green card, given intention to maintain significant Japanese presence, recommend solving for estate tax as a non-domiciliary of the United States
  - Estate tax planning should occur early in process to maintain consistent theme of non-domiciled status
  - Early planning allows for a “change of mind” following implementation of plan. Subsequent change of mind will not undo earlier planning

- Depending upon ability to maintain residence in Japan under treaty with US in next few years, green card remains a viable option (although not without risk to maintaining such status)
  - If Client were treaty-resident in Japan (despite green card holder), may plan as if he were non-income-tax-resident in US – i.e., foreign
Suggested Planning Assuming Non-Income-Tax Resident: Use of Trusts

- Foreign grantor trust for the benefit of wife during her life and children following earlier of her death or Client’s death
  - Trust(s) would be excluded from Client’s estate and thus suffer no US estate tax at Client’s death or that of his wife; Client may enjoy use of trust assets/income via distributions to wife
  - Those beneficiaries who are non-resident of Japan in 5 years prior to distribution (including US citizen daughter) may benefit from income build-up w/o Japanese inheritance/gift tax
    - Consider “loans” from trust to avoid distributions in “tainted” period;
  - If Client moves to US within 5 years of funding foreign trust, trust would be considered a grantor trust to Client while a US resident
    - i.e., income earned in trust is taxable to grantor Client, despite his inability to revoke or benefit
- After Client’s death, trust converts to foreign non-grantor trust
Benefits of Maintaining Flexibility in Trusts

- As Client becomes income tax resident of US, reassess benefits from grantor trust status
  - State tax becomes highly relevant if Client lives in “high tax” State, such as Hawaii, California or New York
  - In case of US resident grantor of a grantor trust (e.g., Client if moves to US w/in 5 years of funding), tax is imposed upon grantor – making them ineligible for credit to a Japanese resident receiving a trust distribution

- US (i.e., domestic) non-grantor trusts are generally considered taxable in the jurisdiction administered such that trusts administered in, e.g., Delaware, Wyoming, Nevada are not subject to income tax on income realized
  - Beneficiaries become subject to income tax only upon distribution
  - Japanese beneficiaries may thus suffer no state tax and may credit US taxes paid against Japanese tax liability under treaty
Flexible Trusts

- Properly drafted trusts should facilitate alternative arrangements for specific beneficiaries
  - Japanese resident beneficiary may enjoy non-US non-grantor trust without adverse US income tax consequences
  - US resident beneficiaries may need US trust to avoid such issues as so-called accumulation distributions and deemed distribution of trust income when using tangible property
    - *A further explanation of the above is beyond the scope of this presentation*
- Following death of grantor (in case of a foreign trust), consider myriad of planning possibilities based upon prevailing facts
Non-trust Assets: Home and LP Interests

- Home in Hawaii not appropriate for foreign grantor trust structure
  - Consider alternative forms of planning which “block” US estate tax and don’t create US income tax “deferral device”
    - E.g., foreign partnerships and check-the-box structures

- Vested and Unvested Options Held in Delaware Partnership
  - Critical to force income acceleration in options prior to entry into US: Otherwise pay tax (at top rates) on all value in excess of strike price
  - Consider planning tools such as causing the LP to transfer, directly or indirectly, vested options for value including a long-term installment note
  - Further consideration of Japanese tax consequences/planning will be required
Social Security/Medicare Tax Issues

- Client may be eligible to elect out of US social security system
  - May not be able to derive meaningful benefits from US social security despite high dollar contributions
  - May not benefit from Medicare unless becomes citizen
- Client should explore planning options in light of the above
**Preliminary Recommendations**

*Immigration*

- Even with a green card, client may be able to plan as a non-income-tax-resident in the US
- If client delays obtaining his green card, the son could enter the US as a student or theoretically under the H-1B program.

*Foreign Grantor Trust for Non-Japanese and Non-US Situs assets*

- Revocable by settlor (client)
- For the benefit of the wife during her lifetime, and the children after the death of wife or settlor, whichever is earlier
- No estate tax at time of settlor or his wife’s death
- Right to benefit after having left Japan for more than 5 years
- Re-assess after arrival in the US for potential conversion into US non-grantor trust
**Preliminary Conclusions**

*Income Acceleration for vested & unvested options in US LP*

- Income acceleration or other planning tools prior to arrival in the US
- However tax considerations in Japan may necessitate the above to take place during a year’s residency in a tax neutral country after leaving Japan and before arriving in the US

*Residence in Hawaii / US – Assume Client is Non-Domiciled in US for Estate Tax*

- Foreign partnerships and check-the-box structures to “block” US estate tax
- Separate structuring from Foreign Grantor Trust
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