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PRE-EMIGRATION WITH A FOCUS ON UNITED STATES

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Immigration to US—Two Tax Regimes to Plan For

- U.S. Gift and Estate Taxes
  - On transfer of worldwide assets of U.S. citizen or domicillary
  - On transfer of U.S. situs assets (vacation homes, real property interests, stocks, options, business interests, etc.) of noncitizen/non-domicillary

A person considering relocating to the US will expose her or his worldwide estate to the US gift and estate tax regime if she or he becomes domiled in the US. Domicile is a function of one's state of mind. You lose your current domicile in favor of a new domicile if you relocate with the intent to live in the new location permanently (and not return to your prior domicile. International case law suggests that such a change is not easily made, but the IRS is likely to be more aggressive in taking such a position, particularly where the immigrant to the US has obtained permanent residency status. To obtain a "green card" one must assert under oath that he or she intends to live in the US permanently, which appears to support an inference of US domicile. Nonetheless, it is a facts and circumstances test, and it is possible that a "permanent resident is not domiciled, or, alternatively, that one with a temporary visa is domiciled.

Assuming that domicile status is averted, an immigrant must still plan for US gift or estate taxes that may be imposed on their US situs assets. For US gift tax purposes, such assets are US real property and tangible personal property situated in the US. U.S. situs assets for US estate tax purposes also include individually owned (or through a look-through entity, such as partnerships or certain trusts), interests in real property and tangible personal property (generally, the contents of real property but including boats and vehicles) that are located in the US, plus two large additional categories: US stocks, and debts of US persons or companies.

Individuals Subject to U.S. Income Tax

- Tax on Worldwide Income
  - U.S. citizen (no matter where resident or domiciled)
  - U.S. resident
    - "Green card" holder; or
    - Satisfy "days test"
      - 1/6 days yr-2 +1/3 days yr-1 + days current yr > 182 + 31 or more days present in U.S. in current year
- Closer connection exception
- Tax treaty rules

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A. Substantial Presence Test

I. Present in the U.S. for at least 31 days during current year; and

II. Is present on at least 183 days within the last 3 years (including the current year.

1) 183 day test = days present in the current year plus 1/3 days present in preceding year plus 1/6 days present in 2nd preceding year. If total of these days equals 183 days or more, then 183 day test is met and individual is a U.S. resident assuming he was present in the U.S. for at least 31 days in the current year.

2) If present in the U.S. for less than 4 30-day months in each of the 3 years, test is not met.

3) "Present" means physically present at any time during the day. There are exceptions to this rule (i.e., for students).

4) Allows individual to get income in January without tax in U.S.

THERE ARE EXCEPTIONS AND EXEMPTIONS THAT APPLY

B. Closer Connection Exception. Even if a person satisfies the substantial presence test, he or she can still be a nonresident if he or she:

I. was present in U.S. for less than 183 days for the current year;

II. had a "tax home" in a foreign country; and

III. had a "closer connection" to the same foreign country than to the U.S.

1) Tax Home - Regular or principal place of business or if there is none, the TP's regular place of abode (regularly resides). If neither, must be in existence for entire current year.

U.S. Congress may be viewed as not only xenophobic but also paranoid where its taxpayers have interests in foreign corporations or foreign trusts. In short, the tax laws' goal is to tax passive income earned by such entities either on a current basis or tax it later as though it was earned on a current basis.

Immigration to US—Two Tax Regimes to Plan For

- Reach of U.S. income taxes on U.S. income tax residents or citizens
  - Worldwide income
    - US definitions of dividends, etc.
    - US grantor trust rules
  - Beneficial interests in non–U.S. estates and trusts
  - Anti-deferral regime for non–U.S. companies

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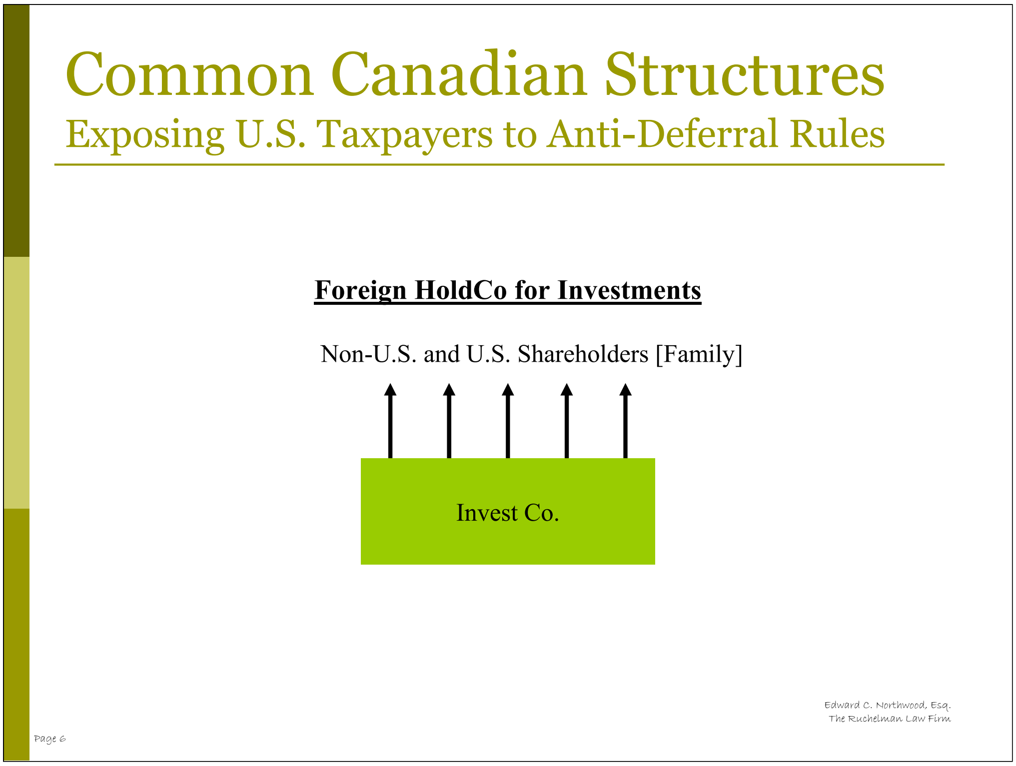
Persons considering moving to the US may generally be aware that their worldwide income may be subject to taxation in the US, but seldom are they aware of broad inclusiveness of the US tax code. For example, in Canada, certain dividends may be received tax-free, but if the company has retained earnings, they will be taxable in the US. Moreover, loans may be re-characterized as dividends.

The pre-immigrants' interests in trusts must also be examined. If the individual contributed assets to a trust in which he or she retains an interest, or which will benefit US taxpayers, or is revocable by the individual, all of the income (and allowable deductions) of the trust will be reportable as the individual's own upon becoming a US taxpayer. (See generally, IRC Sections 671-679.)



From the perspective of a US taxpayer shareholder, a foreign investment holding company will be a PFIC. It may also be a CFC depending on the CFC ownership test. Because CFC trumps PFIC and QEF status, this determination must be made promptly.

Corporate Anti-Deferral Rules

- Passive Foreign Investment Company (PFIC)
  - 75% or more passive income or 50% or more passive assets
  - No minimum U.S. shareholder ownership required
  - Taxed when excess dividend distributions or stock disposed (including nonrecognition transactions), at highest U.S. rate (35%), plus interest compounded over holding period
  - Form 8621

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Passive Foreign Investment Company.

A foreign corporation is a PFIC if it satisfies an income test or an asset test. Under the income test, a foreign corporation is a PFIC if at least 75% of its gross income for the taxable year is passive income under Section 954(c) of the Code.[1] This income generally includes dividends, interest, royalties, rents, annuities, and gain from the sale or exchange of property giving rise to the foregoing types of income.

Under the asset test, a foreign corporation is a PFIC if at least 50% of the assets held by the company during the taxable year produce passive income.[2] For purposes of applying the asset test, publicly-traded corporations generally must use fair market value as the basis for measuring assets.[3] Non-publicly-traded corporations may use fair market value or adjusted basis for measuring assets, except that non-publicly-traded corporations which are also CFCs must use adjusted basis.[4] In testing for PFIC status, various "look-through" rules may apply.

The PFIC regime does not tax U.S. persons currently on income of the foreign corporation (unless a QEF election is made as described below). Instead, U.S. persons are taxed upon receipt of "excess distributions." Excess distributions include both: (i) gain recognized on the sale or deemed disposition of PFIC stock, and (ii) actual distributions made by the PFIC, but only to the extent that the total distributions received in the tax year exceed 125% of the average actual distributions received in the preceding three years.[5] Once determined, an excess distribution is allocated ratably to each day in the U.S. shareholder's holding period for the stock.[6] Amounts allocated to the current tax year and the pre-PFIC holding period (if any) are taxed as ordinary income in the current year.[7] Amounts allocated to the PFIC period (other than the current tax year) are not included in income but are subject to tax at the highest U.S. ordinary income tax rate, plus an interest charge to reflect the tax deferral (the "deferred tax amount").[8]

[1] I.R.C. §1297(a)(1).
[2] I.R.C. §1297(a)(2).
[3] I.R.C. §1297(f)(1)(A).
[4] I.R.C. §1297(f)(2).
[5] I.R.C. §1291(a)(2), (b).
[6] I.R.C. §1291(a)(1)(A).
[7] I.R.C. §1291(a)(1)(B).
[8] I.R.C. §1291(a)(1)(C).

- QEF Election
  - A U.S. investor can avoid excess distribution regime by making an election known as QEF election.
  - QEF election must be made by due date for filing the U.S. investor's tax return for the first year to which the election applies (Form 8621).
  - QEF election to be in effect for all years the corporation was a PFIC.
  - Investor may have the option of filing a retroactive QEF election.

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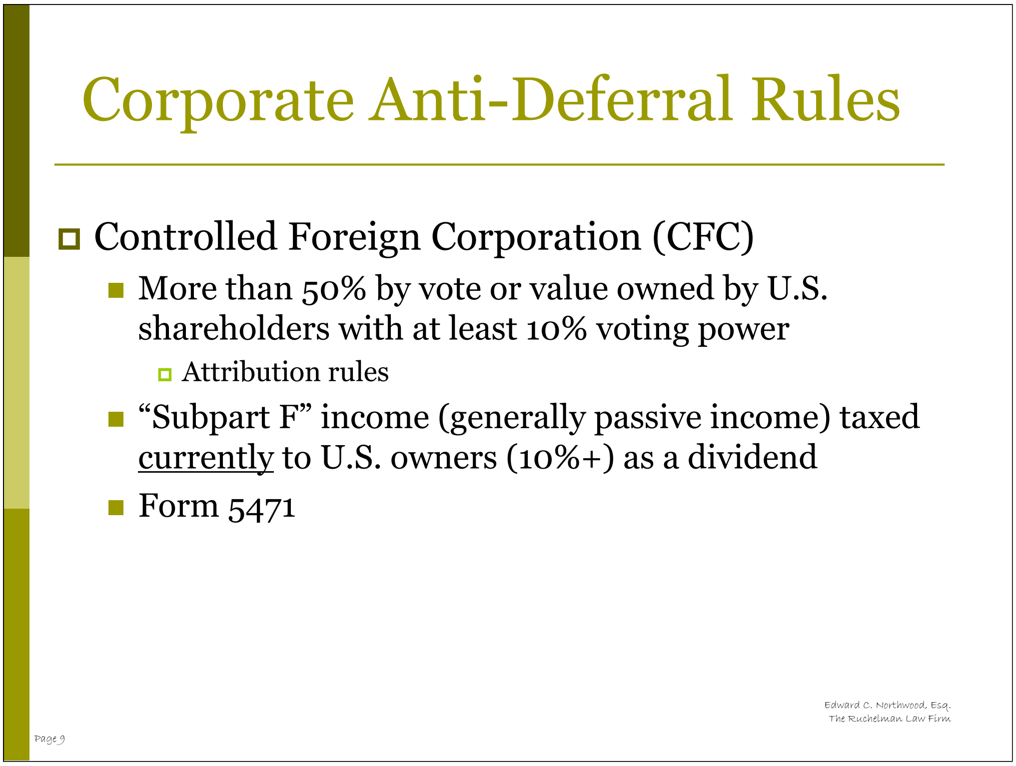
One possible way for a U.S. investor to avoid the excess distribution regime is to make an election known as a QEF election. If such election is made, the investor will be required to include in his gross income each year his pro rata share of the PFIC's ordinary income and net capital gain for the year. The QEF election must be made by the due date for filing the U.S. investor's tax return for the first year to which the election applies. However, if the election is not made for the first year that the corporation was a PFIC, the election will not achieve avoidance of the "excess distribution" regime; rather, the stock will continue to carry "PFIC taint" and be subject to the excess distribution rules upon a sale of the stock. Thus, it may be important for a QEF election to be in effect for all years that a corporation was a PFIC. This may be difficult for investors who learn that the company was a PFIC in a prior year. However, the investor may have the option of filing a retroactive QEF election.

The investor may make a retroactive QEF election if the failure to file a timely election was because the investor reasonably believed that the company was not a PFIC. There are two regimes under which the U.S. investor may make a retroactive election: (1) the protective regime and (2) the consent regime.

Under the protective regime, the investor must (1) have reasonably believed as of the election due date that the foreign corporation was not a PFIC, and (2) file a protective statement in which the investor describes the basis for its reasonable belief and extends the statute of limitations for the assessment of taxes under the PFIC rules. Special rules apply for certain qualified shareholders who own less than 2% of the vote and value of each class of stock of the foreign corporation — who are not required to satisfy the reasonable belief requirement to preserve the ability to make a retroactive election — and can make a retroactive election for any open tax year in their holding period.



Controlled Foreign Corporation.

A foreign corporation is a CFC if "U.S. shareholders" own more than 50% of the total combined voting power or more than 50% of the total value of the stock in the foreign corporation on any day during the corporation's tax year.[1] For this purpose, "U.S. shareholders" are U.S. persons owning, directly or indirectly, 10% or more of the total combined voting power of the foreign corporation.[2]

If a foreign corporation is a CFC for an uninterrupted period of 30 days or more during the tax year, every U.S. shareholder (as defined above) who owns stock in the corporation on the last day of the year must include in gross income: (i) the shareholder's pro rata share of the corporation's "Subpart F income," and (ii) the shareholder's pro rata share of the corporation's earnings invested in U.S. property.[3]

Subpart F income includes various types of income, the most common of which is certain passive income such as dividends, interest, rents, royalties and annuities, and gain from the sale or exchange of property giving rise to the foregoing types of income.[4] Certain amounts are excluded from Subpart F income, including certain rents and royalties derived in the active conduct of a trade or business, and certain dividends, interest, rents, and royalties received from related corporations.[5] There is also an exclusion for Subpart F income subject to high foreign taxes. To qualify for this exclusion, the income must be subject to an effective rate of income tax imposed by a foreign country greater than 90% of the maximum U.S. corporate tax rate, which is currently 35%.[6] U.S. shareholders of CFCs generally are not taxed currently on non-Subpart F income or on Subpart F income in excess of the foreign corporation's earnings.

Another consequence to U.S. shareholders of CFCs is that gain recognized on the sale or exchange of CFC stock may be taxed as a dividend to the extent of the earnings and profits attributable to such stock and subject to the ordinary income tax rates, rather than the lower capital gains rates.[7]

[1] I.R.C. §957(a).
[2] I.R.C. §951(b).
[3] I.R.C. §951(a).
[4] I.R.C. §954(c)(1).
[5] I.R.C. §954(c)(2), (c)(3).
[6] I.R.C. §954(b)(4).
[7] I.R.C. §1248.

Attribution and Constructive Ownership Rules (Substance over Form)

- CFC
  - U.S. ancestors, descendants and spouse (no siblings)
  - Proportional ownership through foreign entities (corporations, partnerships, trusts)
  - 10% threshold for stock owned by corporation in turn owned by individual (directly or indirectly)
  - Grantor trusts — all owned by grantor
  - Complex trust or estate: ownership considered owned by beneficiaries
- PFIC
  - 50% or more of corp. (proportional to ownership interest)
  - Beneficial interest in trusts, estates and partnerships

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The regulations setting forth the attribution rules with respect to trusts are incomplete. To some limited degree, IRS private rulings provide some additional guidance. For example, grantor trusts are attributed to the grantor; simple trusts (ones where all the income is required to be paid out to a beneficiary) are attributed completely to the income beneficiary; and complex trusts and estates are attributed on the basis of distribution patterns. Where there are no patterns of distribution, however, attribution is uncertain.

Planning Around Subpart F

- Avoid becoming a U.S. Income Taxpayer
- Check-the-box to be treated as passthrough prior to US residency (if entity not a “per se” corporation)
- Change foreign corp. ownership
  - Get rid of U.S. shareholder
  - Increase U.S. shareholder %s to make CFC in order to avoid PFIC status
  - Decrease US shareholder’s % to make a PFIC only if residency to be temporary
  - Use look-through rules to “fail” passive income tests
- Limit passive income/passive assets

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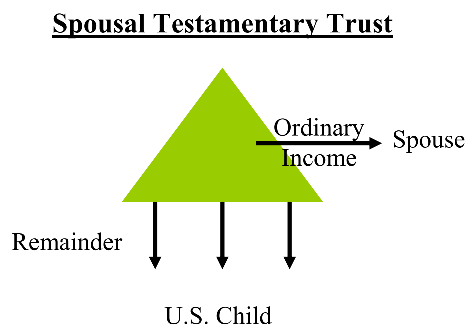
Common Trust Structure Exposing U.S. Taxpayer Beneficiaries to Anti-Deferral Rules



What is a Foreign Trust for U.S. Income Tax Purposes?

- Trust fails either:
  - Court Test (Primary Supervision of Administration)
  - Control Test (U.S. Fiduciary Control over Substantial Decisions)

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A trust satisfies the first test, referred to as the “Court Test,” if a court within the United States is able to exercise primary supervision over the administration of the trust. A court is “able to exercise primary supervision” over the trust if it has or would have the authority under applicable law to render orders or judgments resolving substantially all issues regarding the administration of the trust. The “administration” of the trust includes those duties imposed upon a fiduciary under both the trust instrument and applicable law. The second test, referred to as the “Control Test,” is satisfied if one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust. A “fiduciary” includes a trustee and a protector.

Trusts that will be Taxed to Grantor (US Taxpayer)

- Revocable
- Irrevocable
  - May benefit grantor
  - May benefit Grantor's spouse
  - May benefit US taxpayer (if foreign trust and grantor moves to US within five years of funding)
  - Gives certain powers to grantor

Issues for U.S. Beneficiaries of Foreign Trusts

- Exempt from tax on distribution when a foreign grantor trust, *e.g.*,:
  - Trust revocable by foreign grantor;
  - Taxed to US Grantor; or
  - Distributions may be made only to foreign grantor or spouse during grantor's lifetime
  - Grandfather rule

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A foreign grantor trust funded by someone other than a U.S. person or a beneficiary typically allows U.S. beneficiaries to receive a distribution of current or accumulated income from such trust without subjecting the U.S. beneficiary to U.S. income tax thereon. Most foreign trusts, however, are non-grantor trusts. Generally, all foreign irrevocable trusts that may benefit persons other than the grantor or the grantor's spouse during the grantor's lifetime are foreign non-grantor trusts. A Canadian testamentary trust is a classic example.

Issues for U.S. Beneficiaries of Foreign Trusts

- Distributions from foreign non-grantor trust ("FNGT") of prior year income are subject to accumulation distribution rules: taxed at ordinary income rates (up to 35%), plus interest is imposed to reflect deferral
  - What was capital gains in year earned is taxed as ordinary income when distributed in a later year
  - Interest charge may become punitive

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A U.S. beneficiary of a foreign non-grantor trust generally is taxed on a distribution from such a trust, and an interest charge is imposed as well if a distribution is an "accumulation distribution" (a distribution that is made from accumulated income, rather than current income). This interest charge is designed to penalize the beneficiary because U.S. income tax was not paid in the year when the income was earned. For these purposes, income includes net realized capital gains, even though such gains are allocations to trust corpus for accounting purposes.

The conversion of capital gain income to ordinary income upon distribution as an accumulation distribution (as opposed to a current distribution) remains in the law. Now that the maximum U.S. capital gains tax rate (15%) is less than one half of the top ordinary income tax rate (35%), this rule carries significant additional costs.

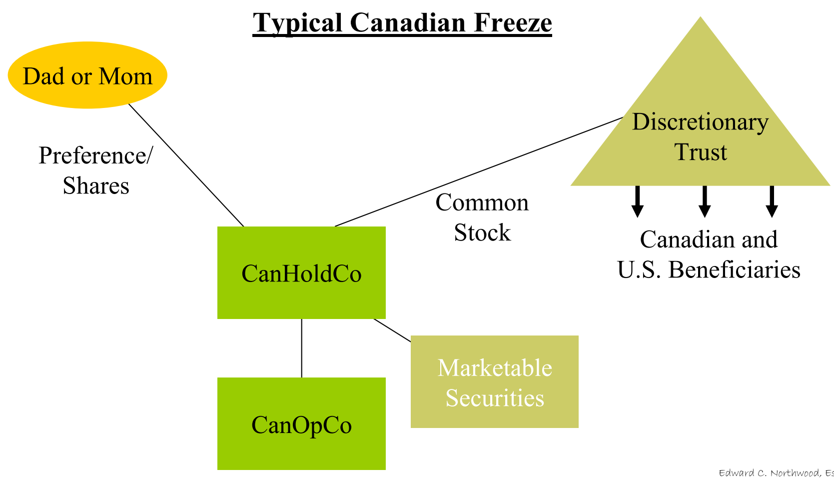
Compound interest based on the underpayment rate is imposed not only on tax amounts with respect to accumulation distributions made since January 1, 1996, but also on total simple interest for pre-1996 periods, if any. To compute the interest charge, the accumulation distribution is allocated proportionally to prior trust years in which the trust has income, rather than to the earliest of such years.

Issues for U.S. Grantors and Beneficiaries of Foreign Trusts

- Complex reporting requirements for U.S. Grantor or beneficiary (whether FNGT or FGT)
  - 35% penalty to beneficiary for failure to comply with reporting obligation (Form 3520)
  - All distributions deemed to be accumulation distributions unless proven otherwise
  - Retirement plans in home country
  - 5% penalty to grantor for failure to comply with reporting obligation (Form 3520-A)

Common Canadian Structures

Exposing U.S. Taxpayers to Anti-Deferral Rules



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Coming to America

- Canadian or Mexican departure tax (and corresponding stepped-up basis in US under Treaty with Canada)
- Other methods of stepping up basis
- Problems with "green card" (permanent resident) visas
  - U.S. income taxation
  - Evidence of domicile?
- Pre-Immigration Trusts for U.S. estate tax minimization planning
- Retirement Plans and IRC 72(W)
- Pre-planning for PFICs and CFCs
- Investment options to shelter income of temporary US immigrants
  - Annuity contracts
  - Insurance policies
  - PFICs (requires 50% or more foreign owners)
- Vehicles for acquiring U.S. situs assets [If temporarily in US]
  - Foreign corporation
  - Limited partnerships
  - Trusts

1. Stepping up the basis of assets for US income tax purposes.

   One does not get a fresh start tax basis on her or his assets on the US residency start date. Instead, historical basis applies. Therefore, pre-immigration planning involves stepping up the basis of all appreciated assets. Under the Canada/US Tax Treaty, a fresh start basis is available for Canadian emigrants to the US with respect to any of their assets that were subject to the Canadian departure tax. Where that exception does not apply other methods must be employed. Examples include: liquidate all holding companies; elect to change the entity classification (check-the-box election); sale of assets to a partnership; and sale of assets to a spouse.

2. Pre-immigration trusts.

   Before an individual becomes domiciled in the US the gift tax regime does not apply. Therefore, one spouse may transfer significant assets into an irrevocable trust for the other spouse (and descendants) on a transfer tax free basis. Bear in mind that the donor spouse may not retain a reversionary interest and that such a trust will be a grantor trust as soon as the donor becomes a US resident taxpayer.

3. IRC 72(w).

   Application of basis rules to nonresident aliens. (1) In general. Notwithstanding any other provision of this section , for purposes of determining the portion of any distribution which is includible in gross income of a distributee who is a citizen or resident of the United States, the investment in the contract shall not include any applicable nontaxable contributions or applicable nontaxable earnings. (2) Applicable nontaxable contribution. For purposes of this subsection , the term "applicable nontaxable contribution" means any employer or employee contribution— (A) which was made with respect to compensation— (i) for labor or personal services performed by an employee who, at the time the labor or services were performed, was a nonresident alien for purposes of the laws of the United States in effect at such time, and (ii) which is treated as from sources without the United States, and (B) which was not subject to income tax (and would have been subject to income tax if paid as cash compensation when the services were rendered) under the laws of the United States or any foreign country. (3) Applicable nontaxable earnings. For purposes of this subsection , the term "applicable nontaxable earnings" means earnings— (A) which are paid or accrued with respect to any employer or employee contribution which was made with respect to compensation for labor or personal services performed by an employee, (B) with respect to which the employee was at the time the earnings were paid or accrued a nonresident alien for purposes of the laws of the United States, and (C) which were not subject to income tax under the laws of the United States or any foreign country. (4) Regulations. The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this subsection , including regulations treating contributions and earnings as not subject to tax under the laws of any foreign country where appropriate to carry out the purposes of this subsection . (x) Cross reference. For limitation on adjustments to basis of annuity contracts sold, see section 1021 .

Leaving America (and stopping taxation)

- If citizen, or Long-time Resident, Expatriation Rules
- All others, fail the days' test (and really depart)
  - Beware retained US situs assets subject to US estate tax
  - Plan for continuing US source income

Summary of New Expatriation Rules

- New bright line test: $2,000,000 asset threshold or 5 year average income tax
  - Limited exceptions for dual citizens and minors
  - No ruling process
- Applies to Long Term (over 7 years) Permanent Residents as well

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U.S. Expatriation Rules

Effective June 3, 2004, the U.S. expatriation rules were rewritten, resulting in objective criteria and some unusual tax compliance provisions.

Application of the Expatriation Regime

There are two sets of rules applicable to U.S. citizens renouncing their citizenship for nationality and tax purposes (i.e., expatriating). One set applies to expatriating citizens that are not deemed to have a tax-avoidance motive for expatriating (i.e., that do not meet any of the three objective tests, discussed below). The tax consequences applicable to expatriating citizens in this category are much simpler and easier to comply with than those under the full expatriation regime. Most importantly, the harsh tax consequences and information reporting requirements imposed on individuals that are subject to the expatriation tax regime do not apply. You will not qualify for the easier regime.

The second set of rules applies to expatriating citizens that meet a certain net worth or average tax liability test, or are not in compliance with their U.S. tax obligations. You will be subject to this set of rules if any of the following is true: (1) your net worth (including interests in trusts) at the time of expatriation is U.S.$2 million; (2) your average U.S. tax liability over the prior five years is U.S.$131,000 (2006); or (3) you fail to certify, under penalties of perjury, that you have complied with your U.S. tax filing obligations for the prior five years (and you have actually so complied.) If

Summary of New Expatriation Rules

- Strict disclosure and 10 year compliance
  - Form 8854: at time of expatriation plus each year thereafter
  - Expanded definitions of US source income
    - CFC dividends and redemptions
- In any year during 10 year period that expat is in U.S. more than 30 days, taxed as if a citizen in that year
  - Worldwide income [anti-deferral rules]
  - Gift tax
  - Estate tax [don't die in that year]