

# THREE TRAPS WHEN SENDING CLIENTS OR FUNDS TO THE UNITED STATES

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# Relevant Scenarios

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- Non-U.S. clients or clients' family members traveling to the U.S. for studies but end up staying and becoming U.S. residents (and later green card holders)
- Non-U.S. clients making substantial gifts to their U.S.-resident family members
- Non-U.S. clients or ancestors set up a foreign trust for the benefit of family members, and one such members became a U.S. resident

# Becoming a U.S. Resident – Tax Aspects

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Tax consequences include:

- U.S. tax jurisdiction over worldwide income and gains
- U.S. reporting of receipt of foreign gifts and distributions from foreign trusts
- U.S. reporting of foreign financial accounts if:
  - Financial interest in account, or
  - Signatory authority over account

# Becoming a U.S. Resident – Tax Aspects

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- U.S. reporting information on  $\geq 10\%$ -owned foreign corporations and partnerships
- Potential application of controlled foreign corporation rules and P.F.I.C. rules
- Estate tax on worldwide assets
- Expatriation tax for citizens and green card holders who are “long term residents”

# U.S. Tax Residence

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- U.S. tax residency determined by one of the following
  - U.S. citizenship
  - Substantial presence test
  - Green card
- Foreign nationals coming to study in the U.S. are not U.S. residents for the duration of their study
  - Student visa
  - Up to five years, and possibly a sixth year for working experience under an O.P.T. visa
  - Staying in the U.S. thereafter would result in becoming a U.S. resident

# Foreign Students Trap

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- While a student:
  - No tax on foreign source income
  - No reporting on foreign gifts
  - No reporting on foreign financial accounts
  - No tax on receipt of gratuitous payments from foreign corporations and partnerships
- Trap – those who stay in the U.S. after graduating their studies and exhausting the O.P.T. will become a U.S. residents
  - All information reporting requirements apply
  - Substantial penalties for noncompliance
  - Gratuitous payments from foreign corporations are taxable as dividends
  - Gratuitous payments from foreign partnerships are taxable as income

# Green Card – Long Term Traps

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- Trap – a green card holder residing in the U.S. for certain amount of time becomes a “long term resident”
  - U.S. expatriation rules apply to U.S. citizens and long term residents
  - Other visas should be exhausted before green card is obtained

# Green Card Trap – Long Term Resident

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- A long term resident is a green card holder in eight taxable years out of the last 15 taxable years
- If foreign individual held a green card at any time within prior 15-year period, relinquished the card, and subsequently reapplies, the prior years within 15-year period can be taken into account in determining status as a long term resident
- Even one day of presence in the U.S. with a green card during a taxable year can cause the taxable year to count in full
- Once long term resident, expatriation rules could apply when green card is relinquished



# Relinquish Green Card After Being Treated as Long Term Resident

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- Expatriation rules apply if:
  - Net worth over 2 million U.S. dollar, or
  - Average income tax over last five years was \$157,000 (adjusted by inflation) or more, or
  - Fails to state under penalties of perjury that he has complied with all U.S. federal tax obligations for the five years preceding the expatriation
- If rules apply:
  - “Exit tax” – deemed sale of worldwide assets at fair market value
  - “Succession tax” – gifts and bequest made by client to U.S. persons will be subject to gift tax or inheritance tax by recipient
    - Even if assets were acquired after expatriation
    - Applicable rate – the highest rate applicable at the time for gift or estate tax
    - Inclusive v. exclusive

# U.S. Gift Tax

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- Applies to donors, with the exception of gifts received from non-U.S. persons who were covered by the expatriation rules
- Gifts that exceed \$100,000 require reporting by the U.S. recipient
- Non-U.S. donors are subject to U.S. gift tax on gifts of tangible property located in the U.S. and U.S. situs real property
- Gifting of an intangible asset is not subject to gift tax by non-U.S. donors
  - Stock
  - Money

# U.S. Gift Tax Trap

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- Trap – not all gifts of money are equal
  - Actual currency is a tangible assets and would be subject to gift tax
  - Wire transfer is treated as an intangible and is the preferred method to be used for gifting U.S. persons
- Trap – transferring cash by wire from a non-U.S. parent's offshore company to a U.S. child will be treated as dividend
- Tip: if a non-U.S. client wishes to purchase an apartment in the U.S. for his U.S. child he should gift him with the funds to buy the apartment rather than with the apartment

# Foreign Trusts

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- Wealthy families often settle irrevocable discretionary foreign trusts to benefit their family members and their issues
  - Those trusts are settled in low tax jurisdictions
- The accumulated income is distributed to beneficiaries at the discretion of the trustee at certain age or at certain events (studies, wedding, medical etc.)
- The beneficiaries are either not taxed or are subject to income tax on the amount received, depending on the tax laws of their country of residence

# Foreign Trusts Trap

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- Trap - in the U.S., distributions of accumulated income from a foreign irrevocable trust are subject to extremely high rates of tax
  - Favorable capital gains tax rate are not applicable
  - The distribution will be allocated to the years of accumulation and interest will be charged on the deemed late tax resulting in very high effective tax
  - Compliance costs for calculating the tax are very high
- These rules do not apply if the foreign trust is a grantor trust with one of the parents as the grantor
  - Must be revocable, or
  - Must provide that distributions can be made solely to the grantor or to spouse

# Foreign Trusts Trap

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- At the conclusion of the grantor's lifetime a grantor trust will become irrevocable and be treated as a nongrantor trust
- Tip – domesticate the trust
  - U.S. trustees
  - U.S. advisors
  - U.S. court control

# Q&A

# The End



# Circular 230 Statement

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