Selected U.S. International Tax Updates That Every U.S. International Tax Advisor Should Know

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Could the IRS Get (and Use) the Panama Papers?

- The International Consortium of Investigative Journalists (ICIJ), which is based in Washington, D.C., holds the Mossack Fonseca law firm's files and posted a searchable database on May 9th
- ICIJ's official position—it won't turn over the records to a government agency
- The U.S. Attorney from the Southern District of New York, whose office has handled numerous tax-related criminal cases, has made an informal request to ICIJ to seek information for a criminal investigation and to speak to ICIJ representatives
- The U.S. Supreme Court held in Branzburg v. Hayes, 408 U.S. 665 (1972), that a reporter has no First Amendment constitutional protection from being forced to reveal information in court, so long as the government "convincingly" shows "a substantial relation between the information sought and a subject of overwhelming and compelling state interest"

Could the IRS Get (and Use) the Panama Papers?

- In U.S. v. Jacobsen, 466 U.S. 109 (1984) the Supreme Court held that the Fourth Amendment does not bar a search or seizure effected by a private individual not acting as an agent of the Government or with the participation or knowledge of any government official
- What if the U.S. government stole the Panama Papers from the ICIJ?
- See, e.g., U.S. v. Payner, 447 U.S. 727 (1980)
- In 1976, Jack Payner, a Florida businessman, was convicted of making a false statement to the IRS (by filing a tax return) based on evidence stolen by an IRS agent from a briefcase in a Bahamas banker's Miami hotel room (and office Rolodex) while the banker was out on a "date" with another agent

Could the IRS Get (and Use) the Panama Papers?

- The Supreme Court held that Payner did not have an “expectation of privacy” in the loan documents even though such documents were covered by Bahamian laws requiring confidential treatment of bank records
- Therefore, the use of documents illegally obtained by the federal government from a third party did not violate the defendant's Fourth Amendment right against unreasonable search and seizure and need not be excluded from evidence

FIRPTA Update

- Protecting Americans from Tax Hikes ("PATH") Act of 2015 (how?—by taxing foreign persons!)
- Increases from 5% to 10% the ownership percentage that under § 897(c)(3) allows small interests in <u>publicly traded corporations</u> not to be considered to be U.S. real property interests (USRPIs)
- The FIRPTA tax does not apply to real property interests that otherwise would be USRPIs if they are held directly by <u>qualified foreign retirement or pension funds</u>, or if held indirectly by them through one or more partnerships.
- Effective for dispositions and distributions after December 18, 2015 [new IRC § 897(l)]

FIRPTA Update

- Increases the withholding rate for dispositions of USRPIs from 10% to 15% for transfers after February 16, 2016
- New IRC § 1445(c)(4)—withholding rate remains at 10% for “residences” (as defined under current law) sold for over $300,000 up to $1 million, and -0- for “residences” up to $300,000
- See Treasury Decision 9751, 81 FR 8398-8402, (February 19, 2016) for the updated § 1445 regulations

FIRPTA Update

- A USRPI is acquired for use as a "residence" if on the date of the transfer the transferee (or transferees) has "definite plans" to reside at the property for at least 50% of the number of days that the property is used by any person during each of the first two 12-month periods following the date of the transfer
- The number of days that the property will be vacant is not taken into account in determining the number of days such property is used by any person
- A transferee shall be considered to reside at a property on any day on which a member of the transferee's family [see IRC § 267(c)(4)], resides at the property
- No form or other document need be filed with the IRS to establish a transferee's entitlement to rely upon the residence exception, but consider a related affidavit

FIRPTA Update

- A transferee who fails to withhold in reliance upon this exception, but who does not in fact reside at the property for the minimum number of days set forth above, shall be liable for the failure to withhold (if the transferor was a foreign person and did not pay the full U.S. tax due on any gain recognized upon the transfer)
- However, if the transferee establishes that the failure to reside the minimum number of days was caused by <u>a change in circumstances that could not reasonably have been anticipated at the time of the transfer,</u> then the transferee shall not be liable for the failure to withhold.
- The exception does <u>not</u> apply in any case where the transferee is <u>other than an individual</u>

Could I Lose My Passport If I Owe U.S. Tax?

- Included in Fixing America's Surface Transportation Act (the "FAST Act"), effective December 4, 2015
- Under new IRC § 7345, Revocation Or Denial Of Passport In Case Of Certain Tax Delinquencies, the U.S. State Department may deny a renewal application or cause the revocation of the passport of a U.S. citizen with a "seriously delinquent" tax debt
- "Seriously delinquent" is defined as greater than $50,000 (adjusted for inflation) of assessed, unpaid, legally enforceable Federal tax liability of an individual, including penalties and interest
- A list of taxpayers meeting the seriously delinquent standard will be compiled by the IRS and provided to the U.S. State Department
- Exceptions include where a taxpayer has entered an installment agreement or made an offer in compromise, where a taxpayer has requested a hearing on a levy, or requested innocent spouse relief from joint liability

Could I Lose My Passport If I Owe U.S. Tax?

- The denial provision applies only when the IRS has assessed a tax deficiency (i.e., that a taxpayer's tax due exceeds amounts paid) and the taxpayer is subject to a lien
- A taxpayer must receive contemporaneous notification from the IRS that they have been certified as having a “seriously delinquent” tax debt, as well as notice of any changes to or reversal of such certification
- “Such notice shall include a description in simple and nontechnical terms of the right to bring a civil action”
- A taxpayer may bring a civil action in a district court or the U.S. Tax Court to determine whether the certification was erroneous or whether the IRS has failed to reverse a certification
- <u>Potential issues</u>—IRS doesn’t have the taxpayer’s correct address to send notifications, possible constitutional arguments

Gifts From Covered Expatriates

- IRC § 2801 was designed to compliment the IRC § 877A expatriation income exit tax imposed on certain individuals renouncing their U.S. citizenship and long-term green card holders (8 of 15 years)
- IRC § 2801 imposes a gift/inheritance tax at the highest current U.S. estate tax rate (upon the recipient, as it would otherwise be practically unenforceable) where any U.S. citizen or resident receives any "covered gift or bequest" from a "covered expatriate" (see IRC § 877A(g)(1)) in excess of the annual exclusion amount (currently $14,000), reduced by any related gift/estate tax paid to a foreign country

Gifts From Covered Expatriates

- A “covered expatriate” is any individual if: (1) the average annual net income tax of such individual for the period of 5 taxable years ending before the date of the loss of U.S. citizenship exceeds (as annually adjusted for inflation, $161,000 in 2016); (2) a net worth as of such date of $2,000,000 or more; or (3) he fails to properly certify that he been U.S. federal tax compliant for the 5 preceding taxable years or fails to submit the required evidence of such compliance (see IRS Form 8854)

Gifts From Covered Expatriates

- Exceptions: the individual—

(1) at birth became a U.S. citizen and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and

(2) has been a U.S. income tax resident (as defined in IRC § 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs, or

(1) the individual's relinquishment of U.S. citizenship occurs before such individual attains age 18½, and

(2) the individual has been a U.S. income tax resident for not more than 10 taxable years before the date of relinquishment.

Gifts From Covered Expatriates

- A "covered gift or bequest" is property acquired by gift directly or indirectly from an individual who, at the time of such acquisition, is a covered expatriate, and any property acquired directly or indirectly by reason of the death of an individual who, immediately before such death, was a covered expatriate
- The IRC § 2801 tax is <u>not</u> reduced by the U.S. gift tax or estate tax unified credit/applicable exclusion amount
- A covered gift or bequest does <u>not</u> include:

(1) a taxable gift by a covered expatriate if reported on a timely filed U.S. gift tax return;

(2) property included in a covered expatriate's gross estate and reported on a timely filed U.S. estate tax return; and

(3) transfers for which a gift tax or estate tax charitable or marital deduction would be allowable if the donor or decedent were a U.S. person.

Gifts From Covered Expatriates

- Under the Proposed Regulations for IRC § 2801 issued Sep. 9, 2015:

1. The following transfers are excepted from being treated as covered gifts and bequests:

(a) qualified disclaimers of property made by a covered expatriate;

(b) qualified terminable interest property (QTIP) transferred by a covered expatriate to his or her spouse; and

(c) bequests from a covered expatriate to a qualified domestic trust (QDOT) for the benefit of his or her noncitizen surviving spouse.

2. A transfer in trust is treated as a covered gift or bequest, without regard to the beneficial interest in the trust or whether any person holds a general power of appointment or power to withdrawal over the trust property. As a result, a transfer in trust would be taxed to either the trust if it is domestic (including a foreign trust electing treatment as a domestic trust), or to the U.S. beneficiaries of a foreign trust as it makes distributions.

Gifts From Covered Expatriates

3. The exercise, release, or lapse of a covered expatriate's general power of appointment for the benefit of a U.S. citizen or resident is a covered gift or bequest; and a covered expatriate's grant of a general power of appointment over property not held in trust to a U.S. citizen or resident is a covered gift or bequest to the powerholder.

4. Domestic trusts are considered U.S. citizens subject to the IRC § 2801 tax. A foreign trust may elect to be treated as a domestic trust for IRC § 2801 purposes. In the case of a covered gift or bequest made to a non-electing foreign trust, a U.S. beneficiary who receives distributions, whether of income or principal, is subject to the tax to the extent such distributions are attributable to covered gifts or bequests.

5. The IRS intends to issue Form 708, U.S. Return of Gifts or Bequests from Covered Expatriates, at the time the Proposed Regulations are published as final regulations to report covered gifts or bequests.

Gifts From Covered Expatriates

- Treasury interprets the marital deduction exception under IRC § 2801(e)(3) <u>not</u> to apply to distributions from a non-electing foreign trust to a U.S. citizen spouse
- Instead, the Proposed Regulations appear to treat contributions to non-electing foreign trusts in the same manner as contributions to domestic trusts — making the determination of whether the marital exception applies <u>at the time of the covered expatriate's contribution to the trust</u>
- On the other hand, the Proposed Regulations acknowledge that a gift or bequest from a covered expatriate <u>directly to his or her U.S. citizen spouse</u> is exempt under the marital exception
- Many practitioners believe that the determination should instead be made <u>at the time of the distribution</u> from a non-electing foreign trust since the IRC § 2801 tax is imposed at that time, and that distributions from a non-electing foreign trust to a domestic trust meeting the marital deduction trust requirements should qualify for the marital exception

Do U.S. Treaties Override The IRC § 2801 Tax?

- If the country where an expatriate became a domiciliary is one with which the U.S. has an estate or gift tax treaty, then certainly in the case of newer treaties, and possibly in the case of the older ones, the transfer of property by individuals who were domiciled in a treaty country at the time a gift or bequest was made would arguably not be subject to IRC § 2801
- Newer U.S. estate and gift tax treaties generally say that if the property isn't U.S. real estate or a trade or business that forms part of a U.S. permanent establishment of the donor or decedent, then it isn't subject to tax when the donor is a resident of the treaty country
- Therefore, IRC § 2801 may only apply to gifts of U.S. real estate and gifts of U.S. business property connected to a permanent establishment
- Gifts or bequests of stocks, and bonds or tangible personal property such as paintings or cars could thus be exempted from the tax
- In addition, under older estate and gift tax treaties, the IRC § 2801 tax may only apply to U.S. situs assets

Pending U.S. Tax Treaties

- Because of a privacy concern, Sen. Rand Paul (R-Ky.) still opposes the pending eight U.S. tax treaties, including protocols to the agreements between the U.S. and Switzerland, Luxembourg, Spain and Japan, new treaties with Hungary, Chile and Poland and an international convention on mutual assistance on tax matters
- Paul has also complained about U.S. implementation of FATCA and potentially CRS
- Paul's ongoing hold has put treaties approved last fall by the Senate Foreign Relations Committee in limbo
- BNA reported on April 7th that without an agreement to advance the treaties by unanimous consent, ratification would require full debate on the treaties that could dominate the majority of a week of Senate floor time, and Senate leaders have so far been unwilling to commit that much legislative time to the issue
- Politics in action or inaction?

Continuing Expansion of Nonresident Alien Deposit Interest Reporting

- Reg. §§ 1.6049-4(b)(5) and 1.6049-8(a) require the reporting of certain deposit interest aggregating $10 or more for an account "maintained at an office within the United States" paid to a nonresident alien individual who is a resident of a country (as shown on a valid Form W-8BEN) that is identified in the applicable IRS Revenue Procedure
- Reporting applies in the case of interest paid to a nonresident alien individual who is a resident of a country that is identified as a country with which the United States has in effect an income tax or other convention or bilateral agreement relating to the exchange of tax information
- The interest payor is required to make an information return on Form 1042-S for the calendar year in which the interest is paid
- Rev. Proc. 2016-18, 2016-17 I.R.B. 635 (4/25/2016), supplementing Rev. Proc. 2015-50, 2015-42 I.R.B. 583 (10/19/2015) represent the current countries subject to the treaty reporting rules

Continuing Expansion of Nonresident Alien Deposit Interest Reporting

- The countries with which the IRS will automatically exchange information are presently: Australia, Azerbaijan, Brazil, Canada, Czech Republic, Denmark Estonia, Finland, France, Germany, Gibraltar, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jamaica, Jersey, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Netherlands, New Zealand, Norway, Poland, Slovak Republic, Slovenia, South Africa, Spain, Sweden, and the United Kingdom
- Fla. Bankers Ass'n v. Dep't of Treasury, U.S., No. 15-969, petition for cert. filed, 1/29/16), which appeals a D.C. Circuit decision) represents a continuing (but to date failing) court battle to avoid the application of these reporting rules

G.D. Parker Inc. v. Commissioner (T.C. 2012)

- A client's common planning question—do I have to pay rent for the use of a residential property owned by my offshore/U.S. holding structure—and if so, how much?
- M. Vanini Investments, Inc. (Vanini), a Florida corporation, owned waterfront luxury homes in both Key Biscayne, Florida and Mallorca, Spain —arguably a strange holding structure
- Vanini's stock was owned by G.D. Parker, Inc. a Florida corporation in turn owned by Vilanova, S.A. (Vilanova), a Panama corporation
- Vilanova was owned by Parker, a Peruvian citizen and resident and an NRA for all relevant U.S. tax purposes
- Parker and his family used both properties rent-free and almost exclusively for their personal use
- The Tax Court held that as the "withholding agent," G.D. Parker, Inc. was liable for the 30% U.S. withholding tax for the rental value of the U.S. and Mallorca properties based upon the "constructive dividends" paid from Vanini "up the corporate chain" to the foreign shareholder

G.D. Parker Inc. v. Commissioner (T.C. 2012)

- The taxpayer's Federal income tax returns reported "rental income" from the Key Biscayne and Mallorca homes through the "reduction of a loan" from the beneficial owner to the taxpayer, but there was no written evidence of the alleged loan
- The court noted that any such "rent" should have been paid to Vanini, the actual owner of the homes, not petitioner—<u>in other words, follow corporate formalities when making payments of income or expenses</u>
- "On the evidence in the record, we do not believe Mr. Parker ever intended to pay rent for his use of the two homes. Rental income was included in petitioner's Federal income tax returns only at the behest of Mr. Parker's accountants. We find that Mr. Parker's rent-free use of the home was a distribution from Vanini to petitioner, followed by a distribution from petitioner to Vilanova, and so on up the chain of corporations to Mr. Parker. "
- Rental value was determined based upon the testimony of the IRS' expert (a licensed appraiser) and <u>not</u> the taxpayer's expert (a real estate broker/sales associate)—<u>use a qualified expert in a tax matter</u>!

How A Non-U.S. Person Should NOT Make a Partial Interest Gift of U.S.-Situs Property

- NRA/NRAD "A" owns unencumbered Florida condominium unit in his own name
- As a gift, A deeds US girlfriend ("B") an interest in the unit as a joint tenant with right of survivorship
- Not long thereafter, A died
- A is treated as making a lifetime taxable gift of ½ of the value of the unit
- Under an apparent "gap" in U.S. tax law applicable to NRADs, the <u>entire value</u> of the unit was then included in A's U.S. taxable estate, as B made no financial contributions toward the purchase or improvement of the unit
- This result potentially could have been <u>avoided</u> by either: (1) A making a gift of a 50% <u>undivided tenant in common interest</u> in the unit instead of creating the joint tenancy; or (2) if the property had been owned by a corporation, gifting its stock

Redstone v. Commissioner, T.C. Memo 2015-237, 12/9/15 – How Far Back Can The IRS Go to Tax an Unreported Taxable Gift?

- Many NRA taxable gifts of U.S.-situs tangible personal property and USRPIs go unreported—how long afterward can they be discovered and potentially cause an IRS exam?
- Example—NRA parent transfers a Miami condo unit to her children as joint tenants with right of survivorship, and then one of the children dies, or the unit will be sold
- If fraud or no reporting—potential exposure FOREVER
- The IRS likely became aware of the gifts as a result of family litigation that commenced in 2006
- The IRS successfully argued that **1972** transfers of stock to trusts for the benefit of the taxpayer's children were taxable gifts, but penalties were abated due to the taxpayer's reliance upon tax counsel in deciding not to file
- Because no U.S. gift tax return was filed to report the gifts, the statute of limitations remained open for the IRS to assess the gift tax deficiency in **2013—more than 40 years** after the transfer

IRS Form 8832
"Check-the-Box" Election Issues

- After all these years, the IRS still can't get it right—make sure you carefully review the IRS' "your election has been approved" letters
- The IRS Ogden, Utah office is treating foreign entities as domestic entities and partnerships as corporations
- We have had to resubmit various elections, which can delay the process, costs more in professional fees and upsets the client
- As Albert Einstein stated, "Only two things are infinite, the universe and human stupidity, and I'm not sure about the former"

New Proposed Regulations for Domestic Single-Member LLCs

- New Prop. Reg. §§1.6038A-1 and -2, issued May 6, 2016
- Treat a domestic disregarded entity that is wholly owned by one foreign person as a domestic corporation separate from its owner for the limited purposes of the reporting and record maintenance requirements under § 6038A
- These proposed regulations would not alter the framework of the existing entity classification regulations
- "In the absence of a return filing obligation (and associated record maintenance requirements) or the identification of a responsible party as required in applying for an EIN, it is difficult for the United States to carry out the obligations it has undertaken in its tax treaties, tax information exchange agreements and similar international agreements to provide other jurisdictions with relevant information on U.S. entities with owners that are tax resident in the partner jurisdiction or otherwise have a tax nexus with respect to the partner jurisdiction"

New Proposed Regulations for Domestic Single-Member LLCs

- Because a domestic single-member LLC is classified as a disregarded entity by default rather than by election and has no separate federal tax return filing requirements, there is typically no federal tax requirement for it to obtain an EIN, although U.S. financial institutions generally require an entity to have an EIN to open an account
- An entity obtains an EIN by filing Form SS-4, Application for Employer Identification Number, in which the entity must identify a "responsible party"—"the individual who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets."
- A disregarded entity formed in the U.S. and wholly owned by a foreign corporation, foreign partnership, or nonresident alien individual, generally need not file a U.S. income or information return if neither the disregarded entity nor its owner received any U.S. source income or was engaged in a U.S. trade or business during the taxable year

New Proposed Regulations for Domestic Single-Member LLCs

- Moreover, if a disregarded entity only receives certain types of U.S. source income, such as portfolio interest or U.S. source income that is fully withheld upon at source, its owner may not have a U.S. return filing requirement
- In general, domestic corporations that are "25% foreign-owned" are required to file an annual return on Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code), with respect to each related party with which the reporting corporation has had any "reportable transactions"
- Because the proposed regulations would treat the affected domestic entities as foreign-owned domestic corporations for these purposes, they would be "reporting corporations" required to file Form 5472 with respect to "reportable transactions" between the entity and its foreign owner or other foreign related parties

New Proposed Regulations for Domestic Single-Member LLCs

- In addition, because these entities would have a filing obligation, they would be required to obtain an EIN by filing a Form SS-4 that includes responsible party information
- The proposed regulations broaden the scope of Form 5472 “reportable transactions” for this purpose
- The term “transaction” is defined in Reg. § 1.482-1(i)(7) to include any sale, assignment, lease, license, loan, advance, contribution, or other transfer of any interest in or a right to use any property or money, as well as the performance of any services for the benefit of, or on behalf of, another taxpayer.
- For example, under these proposed regulations, <u>contributions</u> and <u>distributions</u> would be considered “reportable transactions” with respect to such entities
- The $10,000 per entity per year and other penalties for not timely filing Form 5472 could apply

New Proposed Regulations for Domestic Single-Member LLCs

- Impose a filing obligation on a foreign-owned disregarded entity for reportable transactions it engages in even if its foreign owner already has an obligation to report the income resulting from those transactions—for example, transactions resulting in income effectively- connected with the conduct of a U.S. trade or business
- The IRS is also considering modifications to corporate, partnership, and other tax or information returns (or their instructions) to require the filer of these returns to identify all the foreign and domestic disregarded entities it owns (possibly, by requiring the use of a modified version of current Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities
- We've got time to prepare (and advise our clients)—the new regulations are proposed to be applicable for taxable years ending on or after the date that is 12 months after the date these regulations are published as final regulations in the Federal Register

In Re Wyly

- U.S. Bankruptcy Court, Northern District of Texas memorandum opinion (May 10, 2016)
- The IRS sought **$1.4 billion** from Sam Wyly for alleged unpaid taxes, penalties and interest, and more from others
- **459** page court opinion regarding a massive irrevocable trust structure created by or on behalf of various members of the Wyly family
- A primer on how NOT to establish, maintain and report offshore structures
- In a then heavily-promoted scheme, funds were transferred to client or nominee-settled trusts in exchange for tax-deferred private annuities
- The clients got substantially conflicting related U.S. tax advice from tax professionals (i.e., grantor or non-grantor trusts?) but ignored the danger signs and proceeded anyway
- The court agreed with the substantial penalties imposed for the failure to annually file IRS Forms 3520 (offshore grantor trust with a U.S. beneficiary) and 5471 (certain interests in foreign corporations)

In Re Wyly

- "The Court is convinced—by clear and convincing evidence—that Sam and Charles committed tax fraud. That the tax scheme implemented here was "papered" in such a way as to attempt to shield the Wylys from this outcome is equally clear. But the substance of those documents, if carefully examined, reveals the truth."
- "[T]he Court is convinced Sam knew what was happening in connection with the offshore system and that no money or assets moved within that system without Sam's knowledge and express direction…that Sam's directions to the offshore trustees were usually done through the formality of Sam making his "wishes" known to them—directly or through the trust protectors he appointed—is of little consequence. The IOM trustees never refused to follow Sam's "wishes"…as they understood that their jobs depended upon it. If a Sam "wish" was not granted, they would be removed—plain and simple. The Court does not believe that the law permits Sam to hide behind others and claim not to have known what was going on around him. "

U.S. Pre-Immigration Planning – Part I

- Proper timing and implementation are the keys to successful planning for individuals becoming a U.S. income tax resident, a U.S. estate and gift tax domiciliary or a U.S. citizen—major effects for all such purposes
- Irrevocable trusts provide an excellent opportunity to potentially avoid both U.S. income and estate tax for wealthy foreign individuals expecting to move temporarily or permanently to the U.S.
- Moving to the U.S. can cause worldwide U.S. income, estate and gift tax
- Many assets of non-U.S. individuals can be gifted or sold tax-free—make cash gifts from non-U.S. accounts wherever possible
- Unlimited tax-free gift transfers to a trust are possible so long as the transferor is a non-U.S. citizen or domiciliary

U.S. Pre-Immigration Planning – Part II

- Irrevocable trusts can help avoid forced heirship/community property laws —choose a jurisdiction where the settlor can accomplish his or her dispositive goals
- Consider making the check-the-box election for qualified foreign entities to trigger gains
- Sell appreciated foreign assets and domestic assets where capital gains would be tax-free for an NRA
- Gift shares of other non-U.S. entities or other non-U.S. assets as advance estate planning
- Maintain non-U.S. residency status as long as possible—U.S. tax treaty "residency tiebreaker" provisions may extend it

Foreign Grantor Trust U.S. Income Tax Trap – Pre-Immigration Foreign Trusts

- If the trust settlor becomes a U.S. income tax resident or citizen within five years after "directly or indirectly" transferring property to a foreign trust, it thereafter is treated as a grantor trust as of the "residency starting date"
- If a "foreign trust" becomes irrevocable with no "tainted powers," and the settlor then moves to the U.S. within five years thereafter, this rule applies
- This rule only applies to "foreign trusts," which provides alternative planning possibilities with domestic irrevocable trusts
- Special outbound trust migration rules of IRC § 684
- To mitigate the application of this rule—consider avoiding it through the use of a domestic trust established in a U.S. wealth preservation trust-friendly jurisdiction, or creating a new trust, a resettled trust, or completely or partially domesticating an existing foreign trust

"State of the Art" Pre-Immigration Planning – the "Emergency Funds Trust"

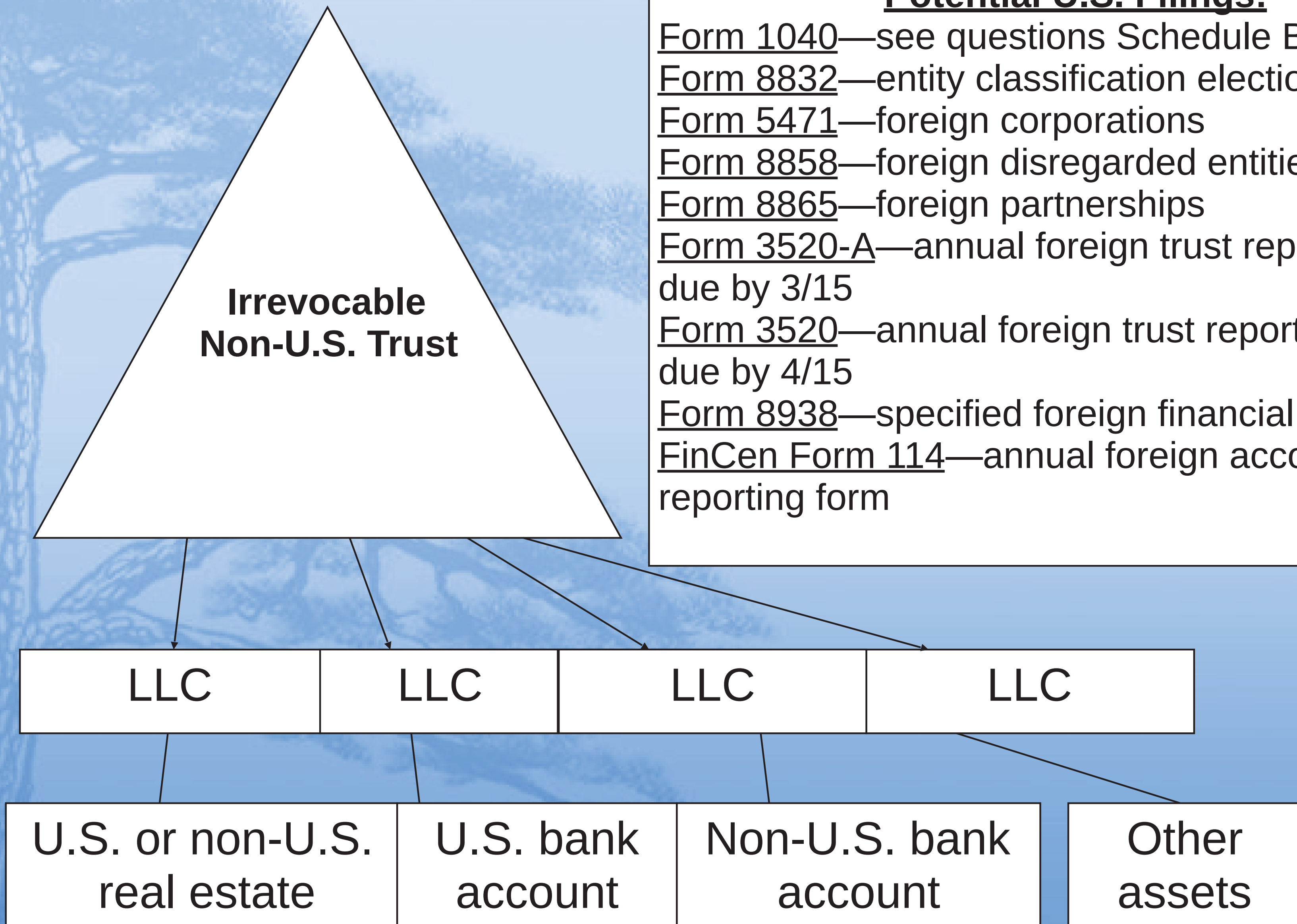
Irrevocable Trust
Asset Protection Jurisdiction
Independent Corporate Trustee

U.S. or Non-U.S. Hold Co	U.S. or Non-U.S. Hold Co
Non-U.S. financial account, other non-U.S. assets	U.S. financial account or U.S. real estate

U.S. Tax and Compliance Considerations
Pre-Immigration Planning Trust Holding Structure

Potential U.S. Filings:

Form 1040—see questions Schedule B, Part III
Form 8832—entity classification election
Form 5471—foreign corporations
Form 8858—foreign disregarded entities
Form 8865—foreign partnerships
Form 3520-A—annual foreign trust reporting form due by 3/15
Form 3520—annual foreign trust reporting form due by 4/15
Form 8938—specified foreign financial assets
FinCen Form 114—annual foreign account reporting form



Transfer Pricing/IRC Section 482

- The IRS has extremely broad worldwide powers and various statutory tools to reallocate the income and deductions of commonly controlled entities
- IRC Section § 482 states as follows:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of § 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

Transfer Pricing/IRC Section 482

- The IRS is telling its agents to take a broad view when determining whether taxpayers are clearly reflecting income from related-party transactions or are trying to evade taxes under Section 482
- On April 6th, the IRS Large Business and International Division told examiners to take a wide scope in finding answers to the questions needed for Section 482 to apply, and provided detailed instructions on what agents should look for in determining whether a taxpayer has clearly reflected income
- The practice unit also provided instructions for looking at whether two or more organizations, trades or businesses are involved in the transaction, and whether there is common ownership or control, either directly or indirectly, of those entities
- "Common control" is defined as any kind of control, and could include control that is direct or indirect, or legally enforceable or not
- Control may involve two or more taxpayers, either acting in concert or with a common goal or purpose. Agents should determine control regardless of whether the reality of the control is decisive.

Transfer Pricing/IRC Section 482

The IRS said auditors should scrutinize whether:

• there is a low U.S. tax rate compared to the sales income reported by the subsidiary;

• the subsidiary is reducing its net income by paying the foreign company too much for goods and services;

• the net income reported by the foreign company or the foreign parent is high, compared to the net income of the U.S. subsidiary;

• the price paid to the foreign company for goods and services that were purchased by the U.S. subsidiary is a factor in the lower net income reported by the subsidiary; and

• the price paid for the goods and services purchased from the foreign parent is higher than expected for this type of product.

IRS Rev. Proc. 2016-7— International Tax Issues on Which IRS Will Not Release Letter Rulings or Determination Letters

- Section 894.—Income Affected by Treaty.—Whether a person that is a resident of a foreign country and derives income from the United States is entitled to benefits under the United States income tax treaty with that foreign country pursuant to the limitation on benefits article. However, the Service may rule regarding the legal interpretation of a particular provision within the relevant limitation on benefits article.
- Section 7701(b).—Definition of Resident Alien and Nonresident Alien.—Whether an alien individual is a nonresident of the United States, including whether the individual has met the requirements of the substantial presence test or exceptions to the substantial presence test. However, the Service may rule regarding the legal interpretation of a particular provision of §7701(b) or the regulations thereunder.
- The prospective application of the US estate tax to the property or the estate of a living person

IRS Rev. Proc. 2016-7— International Tax Issues on Which IRS Ordinarily Will Not Release Letter Rulings or Determination Letters

- Section 864—Whether a taxpayer is engaged in a trade or business within the United States, and whether income is effectively connected with the conduct of a trade or business within the United States
- Section 871—Tax on Nonresident Alien Individuals—Whether a payment constitutes portfolio interest under §871(h) or whether an obligation qualifies for any of the components of portfolio interest such as being in registered form
- Section 894—Income Affected by Treaty—Whether a taxpayer has a US permanent establishment for purposes of any US income tax treaty and whether income is attributable to a US permanent establishment
- Section 894—Income Affected by Treaty—Whether certain persons will be considered liable to tax under the laws of a foreign country for purposes of determining if such persons are “residents” under any US income tax treaty. But see Rev. Rul. 2000-59, 2000-2 C.B. 593

IRS Rev. Proc. 2016-7— International Tax Issues on Which IRS Ordinarily Will Not Release Letter Rulings or Determination Letters

- Section 894—Whether a recipient of payments is or has been a resident of a country for United States tax treaty purposes. However, under Reg. §1.884-5(f), the IRS may rule whether a corporation representing that it is a resident of a country is a qualified resident thereof for purposes of the §884 branch profits tax rules
- Section 894—Whether an entity is treated as fiscally transparent by a foreign jurisdiction under §894(c) and the regulations thereunder
- Sections 1471/1472/1473/1474—Whether a taxpayer, withholding agent, or intermediary has properly applied FATCA or of an applicable intergovernmental agreement to implement FATCA
- Section 2501—Whether a partnership interest is intangible property for purposes of §2501(a)(2) (dealing with transfers of intangible property by a nonresident not a citizen of the United States)
- Section 7701—Whether an estate or trust is a foreign estate or trust for federal income tax purposes